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PRINCIPLES OF MARKETING

A TEXTBOOK FOR COLLEGES AND SCHOOLS
OF BUSINESS ADMINISTRATION

By

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To

Fred M. Taylor

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In the University of Michigan

PREFACE

With the advent during recent years of a buyer's market, the study of marketing has come into prominence. Getting the goods to the consumer has now become as important as the actual production of goods, and the costs are oftentimes as great. This fact, together with the rising costs of living, has directed public scrutiny to the subject of marketing, with the aim of simplifying its machinery and lowering prices. Without presuming to prophesy, conditions seem to point to a still greater interest in the subject in the future.

The present volume is designed as a textbook for schools of business administration, and is intended to introduce the student to the marketing process. It does not attempt to describe all phases of the marketing functions; these are more elaborately comprehended in the collateral readings listed in the Appendix. It seeks rather to unify the subject through analysis and the formulation of principles. What the student most needs, probably, is a viewpoint from which he can intelligently organize the growing mass of material to be found in this new division of economic study.

Emphasis is placed on the marketing of manufactured products rather than that of raw materials and agricultural products, because it is in connection with manufactures that a more decided buyer's market has developed and probably will continue to develop. It is here also that the high costs of marketing, with which the public is so consciously concerned, are more frequently to be found. It is likewise true that the curriculum of schools of business administration is often relieved of an intensive study of agricultural products because

of the close relations of such institutions with schools of agriculture. Yet these other products are not overlooked; a brief comparative study of them is made to give the student a broader comprehension of the entire subject.

While the material herein set forth appeals primarily to students as a branch of economic study, experience indicates that it may prove of value to the business man. The evolution of industry and trade is developing a new type of enterpriser who desires to proceed scientifically. This modern "progressive" in business has been kept in mind in the preparation of this volume. In it he will find an analysis of some of his most vexing problems and a frank treatment of changing business conditions.

The author is indebted in various ways to many recent discussions in books and in trade magazines for which acknowledgment is made in the appropriate places. Valuable aid has likewise been extended to him by various business men as well as by his colleagues in the College of Business Administration in the University of Nebraska. A special debt of gratitude is due to: J. W. Fisk, Manager of Hayden's, Omaha; C. F. Kurtz, Vice-President of The Denecke Company, Cedar Rapids, Iowa; A. E. Simmons, Manager of M. L. Parker Company, Davenport, Iowa; H. B. Whitehouse, Sales Agent of National Cash Register Company, Omaha; R. O. Bell, Merchandise Manager of Davidson Brothers Company, Sioux City; and to Dean J. E. LeRossignol and Professor O. R. Martin of the University of Nebraska.

PAUL W. IVEY

Lincoln, Nebraska,
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Principles of Marketing

CHAPTER I

DIFFERENTIATION OF MARKETING FUNCTIONS

Pressure of Markets upon Production.—The Industrial Revolution which changed the structure of our economic society is still in progress. Its first phase lasted approximately from 1750 to 1880, and was marked by a widening of markets disproportionate to the increase in production. This was a natural result of machine industry, for although by machine processes goods were produced in quantities formerly unheard of, the development of machinery led to better railroads, the telegraph, and the telephone, which extended the market and made possible the immediate absorption of the mass of newly produced goods. Contemporaneously with this industrial development, new areas were being opened up in the United States, population was increasing at a more rapid rate than during any previously recorded period, while habits and customs of centuries were being discarded as a result of contact with new conditions, and in their place was developing a system of wants more complex and numerous than had ever existed in the history of the world.

The lagging of production behind the markets materially affected the course of our economic development. During this period emphasis was naturally placed on increasing production. Schools of technology were organized, scientific factory management received much attention, motion study of employees became common in manufacturing plants, efficiency engineers were called upon to co-ordinate the different departments of production, and inventions which displaced labor with machinery were numerous. Naturally, little attention

was given to analyzing marketing processes. First of all it was necessary that production become efficient.

Development of Traditional System of Marketing.—Since a seller's market (a market in which the advantage rested with the seller) existed during this period, the manufacturer accepted the distributive system as he found it and turned his goods over to the jobber with little thought of the ultimate consumer. It was a roundabout way of getting goods to the consumer, but the market was seeking the goods; the goods were not seeking the market. Heavy demands to increase production were being made on manufacturers, but they had no time or capital to invest in getting the goods to the market. Neither were they interested as to whether or not their products were marketed economically. A marketing structure, which had developed from the changes that followed the Industrial Revolution, was at their dispcsal, and it was natural that they should make use of it since no responsibility attached to the manufacturer and he was left free to devote all of his energies to production.

Pressure of Production upon Markets.—The second phase of the Industrial Revolution dates from 1880 and is still in progress. It is characterized by production which increased at a faster rate than the markets developed. The cause of this reversal of conditions can be traced to: (1) a check in the rate of increase in population, (2) the taking up of unoccupied lands, and (3) the fact that the attention which had been given to increasing production now began to bear fruit. The latter reason is perhaps the most important of all, for each year saw quantities of goods placed on the market for which no obvious immediate demand existed. Production now began to seek markets, where previously markets had sought production. The traditional system of distribution did not

permit of such a ready outlet for commodities as the new conditions demanded, so during this period the marketing system underwent many modifications. National advertising, direct selling, the mail order house, chain store, and department store, are all developments resulting from this new condition of economic affairs.

Elimination of the Middleman.—The popular cry for the elimination of the middleman arises from both ends of the distributive process. The consumer has found it increasingly difficult since 1900 to maintain with constantly increasing prices his standard of living, and in seeking an opportunity to vent his wrath has hit upon the distributive system. The producer in many lines has found it difficult to get an adequate outlet for his goods through the old system of distribution, and has undertaken to educate the consumer to demand his goods from the established middlemen, or he has on his own responsibility set out to fulfil the functions of the middleman.

A great deal of loose talk exists about eliminating middlemen, in which there is no attempt to distinguish between the middleman and the middleman's functions. The middleman himself can be eliminated, but his functions cannot. These must be performed by someone. If the manufacturer is handicapped in securing an outlet for his goods, he may take capital and labor (which under other circumstances would be used in producing goods) and utilize these in gaining markets for his goods. Thus, while he may have gone over the heads of the jobber and the retailer, he has used some of his resources to perform some of the functions which they have been accustomed to perform. In other words, the problem of the present-day manufacturer is not whether he should do away with the middleman's functions, but whether he should take over these functions himself. This naturally brings us to a consideration of the functions of the middleman.

Functions of the Middleman.—The functions performed by the middleman may be viewed as the creation of certain kinds of utilities, i.e., want-satisfying characteristics or operations. Utilities may be classified as form, time, place, and ownership:

1. Form utilities are created when, as in a manufacturing operation, the form of commodities is changed. Thus, steel bars are brought into a factory, they are cut into desirable lengths, and then made into razors. Agriculture likewise produces form utilities with the aid of nature.

2. Time utilities are created by storage. Goods are accumulated when the demand for them is weak, and then are carried over until the demand for them is strong. The storage of ice and vegetables illustrates this classification.

3. Place utilities are created by moving or transporting goods from places where they are little needed, to districts in which the demand for them is strong. Hay in some of our western states would be nearly valueless if it could not be removed to districts where it is less plentiful.

4. Ownership utilities are created by the exchange of goods between people. The grocer creates utilities of this nature when he exchanges flour for money; the real estate agent, who brings together buyer and seller of property and effects an exchange, creates ownership utilities.

Of these four kinds of utilities, marketing deals primarily with the last three. Industry may thus be divided into two divisions: (1) manufacturing, or the creation of form utilities, and (2) marketing, or the creation of time, place, and ownership utilities.

In the creation of time, place, and ownership utilities, the middleman performs certain specific duties, such as:

1. Assembling
2. Grading
3. Storing

4. Transporting
5. Risk-taking
6. Financing
7. Selling

The extent to which each of these factors enters into the distribution of any product varies widely, but all of them usually function to some extent in the marketing of goods from the manufacturer to the consumer. Moreover, they all exist because they satisfy some need; they have arisen as a result of natural causes.

Middleman's Former Functions.—Before the Industrial Revolution, each person whose task it was to get goods from the producer to the consumer performed a part of each function. Each successive middleman, so long as he held title to the goods, assumed the risk of their destruction. The same was true of credit losses. Transportation facilities were provided by each middleman for carrying the goods from the producer's storage house to the consumer. The different middlemen extended either cash or credit to themselves or to each other for the purpose of securing title to merchandise during its successive stages of distribution, or for financing the entire distributtive operation. The selling or disposing of goods to succeeding middlemen was likewise a function of each factor in the marketing process, as was also the providing of storage space for the temporary holding of goods which were physically unready for resale, or for which a market had to be found. Finally, the preparation of goods for resale was a necessary part of each middleman's work. Among other operations, this consisted of: classifying, sorting, cleaning, arranging, boxing, crating and reshipping goods.

Rise of Functional Middlemen.—With the widening of the market following the Industrial Revolution, it became more

and more necessary to have some of these functions performed by specialists. Hence we have the rise of what are known as functional middlemen, viz., insurance companies, transportation and express companies, banks and trust companies, and storage companies. These new middlemen differ from the old middlemen in that they assume one function and not portions of a number of functions. With the development of functional middlemen who have taken over some of the duties of the old middlemen, the importance of the latter has declined; only the functions of selling and the preparation of products for reshipment are left to them.

Separation of Producer from Consumer.—This widening of the market, followed by the specialization of the middleman's functions, removed the producer at each stage further from the consumer. The producer was no longer a merchant and therefore had no direct connection with those who consumed his products. Because of this development, his point of view changed. Goods were now desirable from the standpoint of both producer and middleman to the extent that they produced a profit in resale to the retailer. The characteristics of quality and service acquired prominence only when the retailer came into contact with the consumer. Thus the isolation of the producer from the consumer, due to the former becoming separated from the middleman's functions, has resulted in the offering of incongruous suggestions for the purchase of merchandise—all depending on whether or not the goods are intended for resale or consumption.

Disregard for Consumer.—The producer, because of his proximity to the middleman and his removal from the consumer, is inclined to energize over lowering costs of production so that he may be able to offer a lower price to the middleman, rather than to render his products more capable of

giving satisfaction to the consumer. The degree of satisfaction that the goods are capable of affording the consumer, only indirectly benefits the producer, and does not exert the influence on him that salability to the middleman does. Being uncertain or indifferent to the point of view of the consumer, the possibilities of making improvements in quality and service in his goods are overlooked and are subjugated to the more prominent element of profits.

Handicap in Serving Consumer.—In case, however, producers wish to give prominence to customers' desires rather than to the immediate salability of the product to middlemen, the circuitous manner of transmitting ideas of quality and service through the middlemen to the consumer robs them of their potency and neutralizes their value. The middleman handles so many different products that he can ill afford to give undivided attention to a single commodity and accurately and consistently transmit its claims of superiority to retailers. There is thus a break in the chain of ideas regarding the merchandise, and the retailer, in his attempt to create a desire in the customer for the product, transmits to the latter ideas foreign to those brought to him by the middleman who directly preceded him in the distributive process. For this reason the producer is handicapped, by the traditional system of distribution, in conveying to the consumer accurate, forceful, and clearly differentiated ideas regarding his merchandise. With the increasing competition of producers, this handicap under which manufacturers have been working has daily become more apparent.

Modification of Traditional System. — Because larger amounts of goods similar in kind and quality are being produced by competing concerns, it has become increasingly necessary to differentiate products. Manufacturers have come

to realize that a wide distribution for their products can be secured only by transmitting the idea of their merchandise to the customer so directly that he will be favorably impressed with their particular product. In other words, it has become a common belief among producers that customers should be educated away from the universal understanding that shoes are shoes, or that canned peas are canned peas; they should be trained to think of a certain make or brand when the need for shoes or peas arises. This has led to the identification of goods by means of trade-marks and trade-names. It has also led to a more careful study of the needs of customers by producers; more clear-cut statements regarding the functions of merchandise; and a more critical scrutiny of products by customers. All this has meant a nicer adjustment of production to the needs of the consumer, as well as the production of goods made primarily to render satisfaction rather than to sell.

Direct Communication of Producer with Consumer.—In attempting to get into close touch with the consumer and escape from the pressure exerted by the middleman, the producer has taken away from the middleman a part of his selling function, viz., the communication of ideas, and has turned this duty over to functional middlemen—newspapers, periodicals, and other advertising agencies. The removal of this function from the middleman has further weakened his position, which was primarily endangered when he was separated from the functions of transportation, financing, risk-taking, and storage; and with every decrease in duty, the middleman becomes of less consequence in our distributive system.

Residual Function of the Middleman.—The only remaining important function for the middleman is that of assembling, or of rendering the goods physically available to con-

sumers. This function embraces the operations of classifying, sorting, cleaning, arranging, boxing, crating, and reshipping goods. In some lines of merchandise this remaining function is being whittled down by direct shipments from producer to consumer, but in only a few special cases has this movement resulted in the elimination of the middleman and the transfer of his last function to the producer. This has been true because the middleman is primarily fitted and equipped to perform this function economically, and nothing may be gained by the producer in taking over new duties which are foreign to his specialized work. Only where the middleman has stood as a barrier to a more complete distribution, has it been deemed wise by producers to perform this middleman's function themselves. For the most part, whenever they can get this function performed satisfactorily by the middleman, they are content to leave its performance to him.

Elimination of the Wholesaler.—In some lines of merchandise it has been found desirable to take over the residual function of one of the middlemen, viz., the wholesaler. This has been true where the manufacturer has stimulated a demand for his branded products by direct communication to the consumer of ideas about the goods, and where the cost of performing the residual function of the wholesaler was less for the producer than for the middleman. The desirability of taking over this function of the wholesaler by maintaining branch houses, is illustrated by the advantages accruing to a large paint manufacturer:

1. He is able to obtain the entire time of trained men, devoted solely to the handling of his products.
2. He obtains a direct contact with the retailer dealer, who he finds prefers on the whole to buy directly from the manufacturer.
3. He is enabled to carry larger and better assorted stocks than the wholesaler would be willing to carry.

4. In his experience the credit losses are less when the wholesaler is eliminated.

5. He maintains better control of general policy and prices.[1]

In the case of groceries, however, it is nearly impossible to eliminate the wholesaler for the following reasons:

1. There are so many small accounts to handle that it would be necessary to establish expensive business machinery in order to take care of them adequately.

2. The nature of foodstuffs, like corn flakes, makes it necessary for the retailer to have small shipments quite often, hence the producer would have to have a large force of workers whose sole duty it was to take care of the increased labor precipitated by many small orders.

3. Wholesalers have their distribution machinery established in all parts of the country, which would have to be duplicated by a producer attempting to get a wide outlet for his goods.

In the case of ready-to-wear commodities, on the other hand, where style is a prominent or dominating factor, the wholesaler is very profitably eliminated, and the merchandise sent direct from the producer to the retailer. This is true because:

1. The wholesaler cannot afford to run the risk of style change, on the close margin of profit which he charges for his services.

2. The distribution through the wholesaler is less speedy than by direct methods, and in ready-to-wear commodities the loss of time in delivery means the loss of money.

3. Sudden change in styles has gradually induced clothing dealers to go to market several times a year in order to make certain of securing the latest garments. During these trips

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[1] A. W. Shaw, Some Problems in Market Distribution, p. 87, Cambridge, Mass., Harvard University Press, 1915.

the retailer establishes a personal contact with the manufacturer, thus making unnecessary an intermediary factor in securing the goods.

4. The increasing cost of clothing has resulted in producing a large element of value in proportion to the bulk.

Elimination of the Retailer.—It has already been stated that in some cases it may be advantageous to keep the wholesaler in the distributive process, and in other cases it may pay to eliminate him. The same is true of another middleman—the retailer. For example, a new product coming on the market may not receive the attention either from the wholesaler or the retailer that it should, and hence it may be necessary for the manufacturer to send out his agents to the consumers in order to create an adequate outlet for his product. This was true of aluminum cooking utensils. Retailers had been selling cheap enameled ware and tin, and failed to realize the value of aluminum ware, which cost many times the amount of the older forms of utensils. The only way in which large distribution for this product could be secured was by personal solicitation carried on by thousands of manufacturers' agents throughout the United States. After the consumer-demand had been created, it was found more economical to distribute these products through retailers and wholesalers. At the beginning, however, distribution would have been retarded if the retailer alone had been relied upon.

It has been desirable to eliminate the retailer, either temporarily or permanently, not only in the distribution of new articles like aluminum ware, typewriters, washing-machines, and the like, but likewise in the marketing of products which are: (1) bulky and expensive, and seldom purchased more than once by a consumer; or (2) very expensive in proportion to their bulk. Illustrations of this latter class of merchandise cover watches, clothing, household appliances, machinery ac-

cessories, and similar items which are sold direct to consumers by mail order houses and manufacturers. The former class is illustrated by farm machinery and automobiles. These goods have to be demonstrated; expert salesmanship must be used to demonstrate their advantages if a satisfactory outlet for the factory producing them is to be developed. As demonstrations and specialized salesmanship cannot be supplied by the retailer, the manufacturer obtains special experts for the purpose, and thus the retailer is eliminated.

Establishment of Business Connections.—It may have appeared from the previous statements that the selling function has been largely taken away from the wholesaler. In fact, only part of his selling function has been taken away, i.e., the communication of ideas regarding the goods to the consumer. The remaining part of this function consists of establishing business connections with manufacturers and retailers. This often demands personal solicitation and continuous correspondence, even though the manufacturer performs the function of conveying ideas regarding the merchandise, and adjusts the numerous everyday complaints and misunderstandings that arise. This aspect of selling cannot be taken over by a functional middleman, and if not performed by the wholesaler must of necessity fall on the shoulders of the producer. For some time at least, and for some commodities, it will be necessary to employ the wholesaler to perform this phase of the selling function, as well as the residual function already referred to.

Closely related to the selling function is also the desirability of intimately adjusting production to the needs of the retail trade. The wholesaler, through his close connection with retailers over a wide area, is often better enabled to study the retail trade than is the manufacturer. The deadening familiarity of direct contact with the ultimate consumer does

not handicap his judgment, as is often the case with the retailer; neither does isolation, such as the producer experiences, prevent him from maintaining sympathetic points of contact with the consumer. In other words, he has a natural point of vantage in analyzing markets because he is neither too near nor too far from them. Some prominent wholesalers are making use of this advantage, and are enabling the producer and retailer to effect a nicer adjustment of goods to desires.

Again, while functional middlemen have taken over the risk-taking, financing, transportation, storage, and selling, yet parts of these functions are daily being performed by wholesalers in distributing many lines of goods. For example, no insurance can be purchased which will prevent the wholesaler from losing money in case the market price of his commodities falls, except in the case of some kinds of grain where organized speculation exists. Again, the wholesaler must provide storage space in order to regulate the daily flow of commodities; only over long periods of time may it be desirable to employ the storage facilities of the functional middleman. Further, retailers are notoriously "slow pay," and wholesalers finance them by allowing them to run bills for a considerable length of time. Manufacturers are often likewise financed by wholesalers who permit them to draw drafts at the time of shipment.

Merchandise Basis of Middlemen Differentiation.—Differentiation among middlemen has not only developed as regards functions, but also as regards commodities handled. There are wholesalers for groceries, hardware, and shoes, as well as for other goods. This type of differentiation is likewise evident in retailing, where the old-time general store is found only at the country crossroads, and where so-called specialty stores have taken the place of stores which formerly handled two or more different lines of goods. It might appear that

the department store is a violation of this tendency toward differentiation, but this is hardly the case, since the department store is in reality nothing more or less than a group of specialty stores under one roof. In other words, it is in no way to be compared with the old general store. The "department idea" makes the store a number of specialized units.

Effect of Number of Middlemen on Costs.—It is a commonly accepted opinion that if some of the middlemen could be eliminated, the costs of marketing goods would be reduced. Such a contention is based on the belief that since every middleman must take out a profit, the larger the number involved in a distributive process, the higher the selling price must be. According to similar reasoning, the larger number of men employed in the production of a shoe, the higher must be its price, since the wages of several men must come out of the sale price of the shoe rather than the wage of one man. Obviously such reasoning is fallacious. A hundred men each performing one operation on the shoe may make a better shoe, and at a lower cost, than one man performing the entire operation. The same applies to the distribution of goods. Several middlemen between the producer and consumer may enable the goods to be marketed at a lower cost per unit than where a less number exists. Specialization in production usually means a larger quantity and a better quality, and this is no less true in the field of distribution. Why anyone should believe that in production a subdivision of processes is desirable but that in distribution it is not, is difficult to understand. In a seller's market the competition among middlemen to get the goods leads to specialization, but in a buyer's market the opposite tendency exists.

Profits of Middlemen.—If the producer assumes the function of communicating ideas to the consumer regarding the

goods, or turns this function over to a specialized agency, the middleman is performing only part of the function which he formerly performed, therefore he should not receive as large a margin of profit as he formerly did. As a compensation for this lower margin of profit on each sale, the middleman is forced to secure a greater turnover; and this is usually possible because of the consumer-demand created by the advertising producer or his agency. If the producer does not reduce the margin of profit to the middleman, it means that the latter is being paid for a duty from which he has been relieved. Eventually the consumer would have to pay for this inefficiency. Some producers no doubt have been reluctant to assume the function of communicating direct with the consumer, because they have felt that the middleman would expect compensation for that function if he were to continue the physical distribution of their goods.

Summary.—While the evolution of industry during the past 150 years has tended toward the differentiation of the middleman's functions, and has apparently, to some extent, lessened the importance of the wholesaler, the residue of functions left to this middleman makes him of great importance in the present distributive system. In the distribution of some lines of goods it has been possible to eliminate this middleman entirely, by transferring all his functions either to the functional middleman, to the producer, or to the consumer. In the distribution of some other lines of merchandise it has been found desirable to eliminate temporarily the wholesaler, but to utilize him ultimately; while in still other classes of products it has been found disadvantageous to attempt to take over the remaining functions of the wholesaler. Whether any or all of the middlemen can be eliminated depends entirely upon the conditions surrounding the distribution of each particular product. But even when the middleman is eliminated,

his functions cannot be; these must be performed either by specialists who divide his duties among themselves, or by the producer or the consumer, or shared in different proportions by each. Only in an autonomous economic order could marketing functions be eliminated; it would then be necessary to adjust production to consumption because of the close relationship in time, place, and ownership existing between the two.

CHAPTER II

INTEGRATION OF MARKETING FUNCTIONS

Transformation from Seller's to Buyer's Market.—In the last generation there has been an extensive readjustment in the distribution system. At times, this change has resulted in disorder and chaos. The normal course of the distributive process as it had been developed up to that time was from manufacturer to jobber, jobber to retailer, and retailer to consumer, each marketing function in the series differentiated and performed by independent organizations. When within recent years manufacturers, jobbers, and retailers attempted to take over one another's functions, disorder naturally resulted. Integration of marketing functions meant the elimination of some old types of middlemen and the combining of their functions under new organizations. The struggle for survival has made the period of transition a bitter one and most confusing in its significance even to the parties involved in it.

This readjustment was caused by the transformation of a seller's market into a buyer's market, and advertising was destined to play an important rôle in the transition. When advertising became known as a marketing force, manufacturers attempt to use it as a device to eliminate the jobber, and in some cases the retailer. It was believed that a consumer-demand could be created which would make possible a permanent, steady outlet for goods and cheaper distribution. The building up of a sales organization, which this plan necessitated, was often a costly expansion, but the belief was prevalent that a cheaper selling expense would ultimately result.

Readjustment from Manufacturer's Viewpoint.—While the change in relationship between demand and supply was the underlying cause of market readjustments, with the resulting disorder to the mechanism, the immediate reasons for integration are found in certain practices of market functionaries. Manufacturers allege that jobbers refuse to push their goods while giving preference to goods of competitors. A manufacturer desires, of course, to increase his production in order to utilize to the fullest extent the utilities of his plant, thereby reducing unit costs. This desirable result cannot be attained, however, if the larger production has no market. If the jobber refuses to create a market, a natural result will be that the manufacturer will try to create his own market by advertising, and by going into the jobbing business.

The manufacturer further accuses the jobbers of getting out their own private brands in competition with the brands of their clients. These substitute brands, he urges, put out by the jobbers who control the channels of trade to the retailer, not only cut down the market for the manufacturer's product, but endanger the reputation which the manufacturer has built up for his goods. Hampered on every side, out of touch with the markets, and dependent for distribution on jobbers who could not be trusted to push their goods, manufacturers have revolted and gone over the heads of both jobber and retailer.

The manufacturer asserts that it has been necessary in most cases to go over the heads of both functionaries, because the retailer has been controlled body and soul by the jobber. The jobber has made a personal friend of the retailer through long years of personal solicitation by his salesmen. In many cases, moreover, he has extended credit to the retailer until the latter lives only by the jobber's sufferance. Because of his hold upon the retailer, indeed, through the influences alike of fear and of gratitude, the jobber has been able to retain

control of the most important outlet for the manufacturer's goods.

From the point of view of the manufacturer, in short, the old conditions of distribution had become unbearable. When relief appeared in the form of advertising he turned to it eagerly as the solution of his marketing problem. His belief was that the jobber could be eliminated from the marketing system, or be forced to carry the goods because of retailer-demand; while retailers would be coerced to handle the advertised goods by reason of consumer-demand. Unfortunately for the manufacturer, such an easy victory was not to be.

Readjustment from Jobber's Viewpoint.—The jobber's explanation of the present market disorder is as follows. The fault lies largely at the door of the manufacturer, who attempted to go over the jobber's head before the jobber put out his own private brands. The jobber has gone into the manufacturing business or has assumed control of sources of supply as a matter of necessity, in retaliation for the manufacturer's going into the jobbing business. When the manufacturer had taken his brand away, the jobber was left with a retailer market but nothing of a specified character to satisfy the demand. In order to keep his organization intact, the jobber has produced or procured his own brands, or has contracted with others to produce the goods on which he has put his label.

The jobber also blames the retailer. He asserts that as the unit of retailing has increased in size there has been a greater tendency for retailers to go direct to manufacturers for goods, securing thereby the same quantity discount as is given to the jobber. This "cream of the business" jobbers claim for their own, and see no justification for the manufacturer's selling over their heads to the large retail stores. The manufacturer,

on the other hand, replies that he is justified in selling to any store which is willing to buy in large quantities similar to those offered to jobbers.

Because of this narrowing of outlet for the jobber's goods, the latter has in many cases gone into the retail business, thereby stiffening competition in retailing and causing cries of protestation from members of the retail trade. The jobber has replied that he must create a market for his goods by going into retailing, because, just as the manufacturer on the one hand has provided a market for himself by creating a consumer-demand, the retailer on the other hand has sought to eliminate the jobber by going over his head to the manufacturer.

Readjustment from Retailer's Viewpoint.—About the same time that jobbers began complaining that they were being crowded out by the retailers, retailers were claiming that they themselves were being crowded out by the jobbers. This was being accomplished, they said, by jobbers' taking the cream of the retail business, i.e., the trade of large establishments, such as boarding houses, hotels, public institutions, societies, clubs, etc. The jobber replied that these buying units desired goods in large quantities such as were being sold to retailers, and that it was no more than right that they should be supplied direct and given a quantity discount.

Failure of Advertising to Eliminate Jobber.—Through all of this confusion the manufacturer was pushing his advertising in the effort to create a market for his goods, but success was uncertain because of the other factors in the marketing system. Consumers were learning to ask for the advertised goods in retail stores, but jobbers were coaching retailers to substitute their brands for the advertised manufacturer's brands. Substitution proved to be surprisingly easy, and the

longed-for and eagerly sought after outlet for the manufacturer's goods proved to be a mirage. Something had to be done to prevent the retailer from making substitutions. Cleverly distinctive trade-marks and convincing copy would not avail; some other means had to be found.

Return of Manufacturer to Old Marketing Channels.—The manufacturer's pride revolted against making overtures to the jobber and retailer, after every effort had been made to eliminate the former and force goods upon the latter, but such overtures to the majority of manufacturers appeared to be the only way out of the new dilemma.[1] The old channels of marketing had to be retained, while devising some new way to induce the jobber and retailer to co-operate with the manufacturer in getting the largest possible distribution. If a sizeable distribution could be secured, one large enough to enable the plant to produce in the stage of decreasing costs, that was all that the manufacturer desired. And if some *rapprochement* with jobber and retailer could accomplish this result—then that was the result to be sought.

A new turn in the readjustment of the factors of marketing is thus seen in the manufacturer's going back to the old channels of distribution. He is not, however, relinquishing his advertising. He still creates his consumer-demand, but he does not expect too much of it. Consumer-demand is no longer looked upon as a force which is capable of overturning established methods of marketing goods; rather, it is viewed as a device which enables a permanent, stable, progressive trade to be established, if it is used in *conjunction* with present marketing facilities. Advertising is now viewed as a means of securing the co-operation of both the jobber and the retailer, rather than as a means of eliminating either of them.

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[1] Comparatively few manufacturers were able to create their own retail outlets.

Realizing their permanence, the jobber and the retailer are now able to treat with the manufacturer more open-mindedly.

Jobber's Co-operation with Manufacturer.—How has the manufacturer succeeded in securing the co-operation of the jobber in enlarging his distribution? It has been accomplished in the first place by dealing fairly with the jobber and giving him all of the manufacturer's goods. Assured of all of the manufacturer's business, the jobber undertakes to secure it a broad outlet into retail channels. In the second place, assured of a large, staple consumer-demand, the jobber is induced to handle the goods even though the percentage of profit to be secured may be smaller than is derivable from unadvertised brands. In the third place, the jobber is assured of a retailer-demand because of certain methods recently applied in obtaining the retailer's good-will for the product.

Retailer's Co-operation with Manufacturer.—Even after satisfying the demands of the jobber and securing from him wholehearted co-operation in developing wide distribution, the manufacturer had a retailer problem on his hands. The retailer, in many cases, had been opposed to handling nationally advertised merchandise because it carried a smaller percentage of profit than did jobbers' brands. In such cases, even though there was a consumer-demand and the jobber was willing to handle and push the goods of the advertising manufacturer, the retailer was enticed away to longer-profit goods by other jobbers whose interest it was to handle these other lines. This situation demanded an educational campaign for the benefit of the retailer, conducted by the manufacturer, whose interest it was to widen the outlet for his merchandise and make good the vast sums expended in the creation of the consumer-demand.

The effort to get the co-operation of the retailer has taken

many forms. One of the first neecssary steps was to convince the retailer that a larger total profit could be made on advertised brands, even though they did not carry so large a profit per sale as those not advertised. This was often most difficult to prove to the retailer's satisfaction. An advertised article might carry only a gross profit of 25 per cent, while the unadvertised brand perhaps carried a margin of 40 per cent. The manufacturer had to show that the selling of the higher-margin goods lost money to the retailer in the long run. To show this he had to prove that it *cost less to sell* the advertised goods. More of these goods could be sold in a quicker time and by cheaper salespeople, since they were partially sold when the customer came into the store. Likewise, the argument that the store handling well-known goods had the greater prestige was made to do its work. The advantages of a staple demand were not overlooked, while the ability of the jobber to give prompt and efficient service was no doubt another strong argument.

Partial Integration of the Selling Function.—But the manufacturer did not stop here. He not only proved to the retailer that the latter could make more money by handling the advertised line, but he also helped the retailer sell it. In other words, the manufacturer's obligation to the retailer did not cease when the goods were produced and given to the jobber, and when advertising copy had been placed in magazines and newspapers. The manufacturer took upon himself the obligation of moving the goods off the shelves by teaching the retailer methods of salesmanship and advertising within the store. These co-operative selling methods have taken many forms, but the most common of them are found in dealer-literature, window displays and demonstrations.

Dealer-Literature. Dealer-literature has sought to portray the selling points of the goods in the most concise and con-

vincing manner, as well as to indicate the superiority of the merchandise over that of competitors. Human-interest copy, describing processes of manufacture, origin of raw materials, meaning of designs, and history of development, has aroused the enthusiasm of retailer and salespeople. A statement of tests to which goods have been subjected has tended to secure the confidence of the store in the goods, while comprehensive enumeration of ways in which the merchandise can meet the divergent needs of customers has given salespeople interesting and logical material out of which convincing sales talks can be constructed. This effort to make retailers expert in the selling of their goods gives manufacturers an advantage which means more to them than even their consumer-demand.

Window Displays. As regards window displays, some manufacturers provide at cost to the retailer a monthly service of window display. The Victor Talking Machine Company offers a high-grade service which has been worked out by experts. Each window display is tested for its selling power before it is sent out from the factory, and represents a far greater value than it costs the retailer. Each display is designed with attention, not merely to selling power, but likewise to ease of installation. Each one can be quickly set up by unskilled salespeople and is arranged in parts so that they can be made to fit any shaped window.

Demonstrations. Besides these internal methods of rapidly moving the advertised goods off the shelves, demonstrators are sent out from the factory from time to time to prove to the store's customers that what is claimed in their printed matter is true. These demonstrations, while valuable as advertising and as serving to bring new customers into the store, have their greatest value in creating in the retailer and his salespeople renewed enthusiasm for the merchandise. When the salespeople are themselves sold, there is little difficulty in selling the public. The manufacturer is beginning to

realize that he must sell the retailer and his salespeople the idea of the merchandise before he can hope to sell them the merchandise itself. And this is seen to be true even though there is an order of the actual merchandise in the store. More merchandise will not be ordered unless the merchandise in stock moves quickly. The methods indicated above are designed to result in quick turnovers.

Extent of Manufacturer's Co-operation.—It might appear that the manufacturer has more than met the retailer half way in his attempt to increase the distribution of his product. However that may be, he seems willing to go even further. Many of the more progressive manufacturers are not satisfied with educating the retailer to sell more of their own goods, but they are carrying out a plan of retailer education which seeks to enable the retailer to sell more of all goods. Justification for this wider education is derived from the growing belief that the more prosperous the retailer can be made, the better customer he becomes. The more prosperous he is, the sooner he pays his bills, the more trade he draws, the more loyal he becomes.

The nature of such wider retailer education varies under different circumstances, and with the needs of the various merchants, but usually covers better accounting methods, more efficient store arrangement, up-to-date advertising, business-building salesmanship, trade information on how to meet competition, specific questions with reference to price-fixing, figuring turnover, etc. The merchant is indeed indebted to the manufacturer who expends his efforts and money in such service.

Co-operative versus Coercive Methods.—Thus it is seen that manufacturers are getting away from coercion and are adopting co-operative methods of increasing their distribution.

They have come to the realization in many cases that they cannot perform the jobbing function so cheaply as the jobber, and that it is desirable to retain this functionary in their distributive scheme if he can be induced to push their goods. This object has been attained, at least in part, by helping the jobber get a market for their merchandise, and by assuring him 100 per cent of the output.

The manufacturer has also come to realize that he must co-operate with the retailer. Hence he is taking upon himself some of the responsibility of getting the goods off the retailer's shelves. He is proving to the retailer that quick turnover is not a mirage but a reality. Because of this tangible proof the retailer is much more attracted toward advertised goods, even if they bear a less percentage of profit than unadvertised brands. The retailer seems to be the keystone in the marketing arch. A readjustment of stones has been made and some of them have temporarily been left out, but the retailer's position has been recognized as the most strategic. A realization of this fact by retailers ought to go far towards voluntary co-operation on their part with the other functionaries in the marketing system, to the benefit of both themselves and the consumer.

Co-operation or Integration.—It is apparently true that where co-operation is impossible integration is inevitable, and where integration is impossible co-operation is inevitable. In the majority of cases integration of marketing functions has been impossible for several reasons:

1. Manufacturers lack capital to purchase or create their own retail stores.
2. They lack ability, capital, and experience to create their own jobbing department.
3. They cannot secure wide distribution through small selling organizations.

4. In territories where their own selling organizations cannot penetrate, their products are boycotted by retailer and jobber.

Where wide distribution can be secured for a product by eliminating the middleman and taking over his functions, integration is the logical development; where the difficulties involved in the combining of functions are too great, wide distribution can be secured only by intelligent co-operation with the existing marketing mechanism. Such co-operation is going on in grocery, jewelry, and other lines where wide distribution is difficult to secure through a manufacturer's selling organization.

Co-operation a Stepping-Stone to Integration.—It may develop that close co-operation between the market functionaries will ultimately produce a few large integrated systems, rather than numerous small independent organizations. Co-operating with a merchant to the extent of moving his goods off the shelves and improving his general merchandising methods may possibly lead to a more intimate association. Other selling functions of the retailer may be taken over by the manufacturer, resulting at last in complete integration with this manufacturer, or other stores with which this manufacturer has similar connections. Although drug manufacturers had apparently insuperable difficulties to overcome in securing their own retail outlet, these have been overcome by a co-operative combination of stores in which they are financially interested, the stores in turn having acquired an interest in the business of the manufacturers. In this instance, a co-operative beginning has led to integration throughout a wide field. Similar tendencies are seen in other directions.

Potential Supply as an Integrating Force.—It has already been indicated that integration became an important disturb-

ing force when the supply of goods increased at a more rapid rate than the demand. It should be made clear, however, that by supply is meant potential supply, not the actual amount of shoes, clothing, or furniture that is on the market at any one time, but rather the productive capacities of manufacturing plants. At the present time it is possible to produce goods in very large quantities, whereas during the last century productive capacity was much more narrowly limited. If productive capacities are utilized to their fullest extent, costs per unit of product decline; if they are only partially utilized, costs are higher. In order to get into a more advantageous producing stage, an outlet for production must be secured. Only through an increased outlet can production in decreasing costs be made possible. Efforts at co-operation with market functionaries, and schemes to eliminate them, are alike results of the existence of enormous potential supplies.

Chief Advantage of Decreasing Costs.—The decreasing cost stage of production is eagerly sought after by manufacturers not merely because it will return larger immediate profits. There is a more vital motive. Production under decreasing costs produces a cushion of profits which serves as an insurance fund for the profitable continuance of the business during periods of depression and in spite of vigorous competition. For example, if the production cost (including a fair profit) of an article is 20 cents because of production under decreasing costs, while the production cost of a similar article made by a competitor is 24 cents because of less favorable production costs due to inadequate distribution, the selling price of both will be fixed by the producer of the second article at 24 cents. The first manufacturer could by selling the article for 20 cents drive his competitor out of business and take over his trade, thereby increasing his own scale of production and possibly decreasing

costs still further. Under ordinary competition, however, he would probably not elect such a course, but would sell his article for 24 cents, making an extra profit of 4 cents per article. This extra profit in the aggregate will serve as a cushion to ease up the shock of adverse business conditions, while if the market contracts he is able to lower his price to 20 cents and put his competitor out of business. It is this protection which decreasing costs give them that makes manufacturers struggle for wide distribution. The wide distribution will enable them to produce under the most favorable cost conditions. In some lines integration of marketing functions produces the desired result; in other lines co-operation in its varying degrees of completeness makes possible at least a temporary enlargement of distribution. The struggle for business protection is at the root of the struggle for markets.

It often happens that when a manufacturer seeks to find his own markets his distribution costs are higher than when he turned over this function to one of the old specialized agencies. Where the jobber's selling expense may have been 10 per cent, the manufacturer's selling expense may be twice that. With increased production, however, the savings due to decreasing production costs may more than offset the loss incurred by the sales organization. It is with this possibility in view that some manufacturers maintain costly sales organizations when they might have a lower selling expense through some independent organization. As the volume of goods produced and marketed increases, not only may the production be carried on under decreasing costs but also the marketing. This result, insuring a double protection to the entire business, is naturally the aim of manufacturers.

CHAPTER III

THE WHOLESALER

Unjustified Criticism of Wholesaler.—Unfamiliarity on the part of the public with the wholesaler's or jobber's services to the manufacturer and retailer has led to much unjustified condemnation of this middleman. It is doubtless believed by many that prices would be lower if the marketing route could be shortened by eliminating the wholesaler and having the manufacturer sell direct to the retailer. Whether or not such would be the case depends on:

1. Whether the wholesaler is performing useless functions.
2. Whether the wholesaler is performing necessary functions in an inefficient manner.
3. Whether the manufacturer and retailer can perform these functions more advantageously for all concerned.

The nature of the wholesaler's services must, however, first be considered.

SERVICES RENDERED MANUFACTURERS

Establishing Connections with Retailers.—It is usually necessary to establish trade connections by means of personal solicitation. For this purpose the wholesaler provides the manufacturer with a trained sales force which covers a vaster area in a more intense manner than the manufacturer could himself. Few manufacturers of a competitive line of groceries could carry a sales force large enough to establish connections

with the 300,000 retailers of food products; many dealers away from the beaten paths of trade, in any particular section of the country, could not be visited by the manufacturer's staff because of the expense involved. For example, a manufacturer of pickles could not afford to send his salesman to a dealer when the expense of calling on the dealer exceeded the profit derived from the probable sale. A wholesaler, however, could afford to call on such a dealer, since pickles is only one of a thousand products which he sells, and the expense of making the call would be spread over many products purchased by the dealer. The expense of selling pickles through the wholesaler would therefore be but a fraction of what it might be were the manufacturer to sell through his own sales force.

Manufacturers who have sought to secure their own dealer-outlet for their products have done so because they believed that their products were not being "pushed" by the wholesaler's salesmen. Their idea of intensive dealer cultivation seemed at variance with the method of selling pursued by the wholesaler. The latter handled so many different products that it seemed impossible for him to push any particular line. In order, therefore, to increase his sales in any one locality, the manufacturer created his own selling organization, with the end in view of extending the area of the selling field as each section became saturated with his product.

Experience has shown, however, that even when sales saturation of territory is desired, there is another alternative for the manufacturer than that just described. This consists of creating consumer-demand by means of advertising, thus magnifying the value of the product in the mind of the retailer, who in turn conveys this emphasis to the wholesaler. In conjunction with this method, a campaign to educate the wholesaler's salesmen regarding the merits of the goods, tends to give the products a prominence in their minds which ulti-

mately means greater emphasis by the salesmen when selling their line to dealers. Thus, from both the consumer and wholesaler end, pressure of ideas can be brought to bear which will tend to produce larger sales per dealer, without the necessity of canceling the wholesaler's services and creating a selling organization for the manufacturer's sole use.

Regulating the Flow of Commodities.—The wholesaler forms a central reservoir into which regular shipments of goods are periodically dumped. Here they are stored until they can be broken up into smaller lots and distributed among retailers. To absorb a known quantity of goods during any period, and to store these goods until needed by dealers, are functions of prime importance, demanding equipment, labor and risk-taking which would add materially to the duties of the manufacturer if he attempted to perform them. Moreover, the fact that these functions are turned over to a specialist means that they are more economically performed, and that they add less cost to the final price the consumer pays for the commodity.

It must be evident that storage is absolutely necessary in connection with the manufacture of commodities, if factories are to run uniformly and without interruption. Without storage facilities, factories would work at top speed during part of the year when the current demand was great, and during other parts of the year when demand was slack would run with a reduced labor force. Such a lack of uniformity in production would add to the cost of the commodities, since speeded and overtime production and slack production indicate inefficient methods of operating a plant. Only when all the facilities of the factory are being utilized to a well-defined limit can the per unit cost of production be held at the lowest point. Above or below this limit loss ensues. It is therefore the function of the wholesaler to draw from the manufacturer

regular amounts of goods that come from a uniformly productive process, and to hold them until they can be passed along to the retailer.

Grading and Classifying Commodities.—The demands and preferences of the trade are not the same in different parts of the country. Because of this fact, commodities must be sorted according to quality, size, style of package, and the like, and must otherwise be prepared for market. This function the wholesaler performs in the light of his extensive knowledge of the trade. It is, therefore, performed by a specialist who levies a less charge against the commodity for these services than would otherwise be the case. Furthermore, the taking over of this function by the middleman amounts to the latter's extending more credit and capital to the manufacturer with which to carry on the specialized work of manufacturing. Because of this larger amount of capital available for manufacturing purposes, the output should be larger, with a corresponding reduction of the cost per unit. Hence the consumer presumably will pay less for the commodity because the wholesaler assumes this function.

Freeing Manufacturer from Retail Credit Problems.—To deal directly with retailers demands a large investment of capital tied up in numerous accounts, the assumption of credit risks, and the clerical expense incident to the establishment and maintenance of the business machinery necessary for the proper accounting of large quantities of goods. If the manufacturer of a grocery specialty with a national distribution should desire to sell direct to retailers, it would be necessary to carry more than a quarter of a million accounts. Many of these accounts would be "slow," thereby absorbing important increments of capital that would otherwise be employed in increasing production. Moreover, some capital

would be completely dissipated, since losses because of bad debts increase with the number of the accounts, and with the changing character of the accounts, i.e., from wholesaler to retailer. These factors would in many cases handicap the manufacturer, and would result in loss if performed at an expense exceeding that at which they could be accomplished by the wholesaler who specializes in such functions.

When dealing with the wholesaler, the manufacturer gets his money in ten days or less. His capital is therefore liquid and can be turned back into the business as rapidly as it is transformed into goods. The manufacturer's accounts are few compared with those necessary when selling to the retailer; possibly they do not exceed a couple of thousand. As it is a much simpler problem to keep up to date the credit standing of this limited number of firms, the credit risks are materially less. Accounting machinery is correspondingly simple and inexpensive. Large and expensive duties are, therefore, taken from the shoulders of the manufacturer when he follows the policy of selling by means of the wholesaler. He could perform these duties himself, the same as he could make the machinery for his factory, but he is a specialist and finds it to his advantage to have all services except that of manufacturing performed by other specialists. Of course, where these external functions are not performed efficiently by the wholesaler, then no alternative except that of taking them over by the manufacturer may exist.

Analyzing Market Conditions.—With the increase of time and space intervening between the production and the consumption of commodities, the problem of determining when and where goods should be sold, and in what quantities, qualities, styles, shapes, and sizes they should be placed on the market, has become one of extreme complexity. Unless the pulse of the market is felt with understanding, possibilities

of overproduction or underproduction are ever present, with an attendant loss to the manufacturer in each case. Here is a situation demanding a specialist, and the wholesaler has thus far qualified to some extent for the position. His advantage over the manufacturer is found in: (1) his organization, and (2) his position in the marketing process.

The wholesaler's organization is one which almost automatically provides him with invaluable market data. He is intimately in touch with actual business conditions throughout the country, or in any particular section, because of his staff of salesmen who are sending in daily and weekly reports from the field.

These salesmen's reports often deal with such topics as changes in the trend of demand, stoppage of demand, increase or decrease in spendable incomes, disturbing factors, calamities, activities of competitors, activities of substitutes, and the like. The wholesaler may therefore be in a position to give valuable market information and advice to his clients. The only difficulty is that where there are many clients, a clash of interests may be almost inevitable.

The wholesaler's position in the marketing process is one of advantage in interpreting the data brought in from the field. Being one step removed from the physical process of production, the wholesaler has a wider perspective; he is better able to judge market data impartially without being prejudiced by the ever-pressing manufacturing problems. In his advantageous position he can see contending conditions in their true relationships. He is likewise far enough away from the consumer not to be distracted by unimportant local movement, and yet close enough to know the trend of the movements taken as a totality. Knowing other than local markets, and also the movements of other wholesalers, the typical wholesaler occupies a position of vantage in gathering and interpreting market information.

SERVICES RENDERED RETAILERS

Establishing Connections with Manufacturers. — The wholesaler brings the retailer in contact with many sources of supply, some of which would otherwise remain unknown. This is accomplished by means of a sales force which may carry the goods of many different manufacturers. By such an organization the offerings of the market are brought to the retailer, making it unnecessary for him to seek out the manufacturer. The retailer is therefore relieved of much responsibility of hunting up goods, and at the same time is educated in respect to the available supply of merchandise of many different origins and varieties. His problem of buying is made easier, hence he can give more of his time and energy to the selling phases of his work.

The retailer is also relieved from the necessity of carrying many accounts with manufacturers all over the country, and is enabled to concentrate his purchases in a few wholesale houses. This service reduces the clerical expense in stores, and simplifies the accounting organization of the small retailer. Much time and expense is saved in making claims and complaints, because these can be registered with one or two wholesalers even though the causes for the complaints or claims may be represented by merchandise in widely differing lines. Moreover, the time required to look over the line of goods presented by the wholesaler's salesman is much less than would be the case if these goods were carried by many different salesmen from different manufacturers. The time already spent by retailers in looking over salesmen's samples is a great drain on their possible activities. Any further encroachment in this direction must justify itself by a corresponding benefit.

Storing Commodities.— The average retailer does not have adequate storage space, equipped with efficient devices for

making goods quickly accessible, and designed to preserve merchandise from deteriorating influences. Disregarding the capital invested in the goods themselves, the retailer does not have the available capital to provide comprehensive facilities for caring for large shipments of merchandise. To provide such facilities would mean the draining of important increments of capital from the purchase of stock. To carry large reserve stocks would mean speculation in respect of their market prices. Under present conditions much of this market risk is borne by the wholesaler who is better supplied with capital and possesses a more comprehensive knowledge with which to meet the situation.

From the wholesaler's storage of merchandise extremely small units must be sent to retail stores from day to day, and often on a few hours' notice. This of necessity is the case, because retailers are required to carry a large variety of goods and with limited capital can handle but a little of each at a time. Where the small retailer has attempted to pursue the opposite course, and has purchased in quantity, he has almost invariably failed. Under normal conditions, the turnover is one of the most important principles of merchandising and no retailer can afford to overlook it. Small, clean, up-to-date, well-selected stocks that are moving, produce profits; while large stocks which become sluggish because of change in demand, deterioration, or lack of interest on the part of salespersons, are liabilities that are a heavy burden on the vitality of any store. The elimination of the wholesaler would mean a radical change in present-day merchandising methods, or else the taking over by the manufacturer of the function of releasing small units of goods to tens of thousands of merchants widely scattered over the country.

Financing the Retailer.—Although the functional middleman—the banker—has assumed a large portion of the func-

tion of financing the distribution of goods, yet the wholesaler has large amounts of capital tied up in financing operations. A large part of these financing operations must continue to be performed by wholesalers, since bankers are generally reluctant to extend credit on the character of the security or the lack of security offered by extensive numbers of retailers. A distinct and exclusive service is therefore rendered many retailers, when wholesalers extend credit to them in the form of a stock of goods, or permit accounts to run for a longer period than is the case when manufacturers sell to wholesalers. Without this intimate financial aid men with small captial would be handicapped in entering business, or be entirely prevented from going into business for themselves. This is especially true of the neighborhood store, which has arisen because it performs a valuable service for outlying customers. The cost-to-sell of these stores may be greater than stores nearer the beaten paths of trade, because of the very fact that wholesalers' discounts are not taken up, but these higher costs are made up by the store's clientele who receive place utilities in connection with their merchandise.

Competition also is stimulated by this financing function of the wholesaler, and consumers receive their goods at a price which in many cases leaves no profit for the retailer. In other words, profits tend toward the vanishing point where strong competition exists. Among the small retailers there is not only strong competition, but excessive competition, thereby insuring the customer his merchandise practically at cost. With a smaller number of retailers, a greater possibility of price understanding would exist, which would aim at maintaining a price that would make possible a profit to all stores that come to an "understanding." It is possible that this excessively strong competition is a bad thing for society, but at any rate the generous extension of credit by wholesalers which makes this condition a possibility must be considered

as an important service to the small retailer, or the man who desires to go into business for himself.

Analyzing Retail Conditions.—An increasingly important function of the wholesaler is that of studying the needs of the retail trade. The wholesaler is coming to realize more clearly every year that his prosperity is inseparably bound up with that of the small retailer. He makes possible the small retailer, and in turn is maintained by him. If one goes, the other also goes. Realizing this intimate connection, the wholesaler is endeavoring to help the retailer purchase those goods which will readily turn, and thus lay a foundation for continuous future sales. This new development is quite in contrast to the former policy often practiced by wholesalers of loading up retailers with more goods than they could sell. When the wholesaler's position in the distributive process is secure, such a policy might be followed for a time with impunity; but with the present movement of manufacturers to get a broader and quicker outlet for their goods, and the corresponding tendency to eliminate the wholesaler wherever possible, the latter has recognized his danger and has strengthened his position by developing a community of interests with the retailer. That the retailer is recognizing the value of this co-operation is evidenced on many sides.

The elements involved in a study of retail needs vary with different commodities. Changes in demand must be sensed, shortages in supply anticipated, degree of saturation in a territory determined, local peculiarities analyzed, and surveys of competitors projected. What the retailer should purchase, how much he should purchase, and when he should purchase it, are as much wholesalers' problems as they are retailers'. Moreover, although the retailer is physically intimate with conditions in his territory, he is more often mentally a stranger to circumstances which vitally affect his business.

The wholesaler, with a broader vision and knowledge of what is going on elsewhere, can more adequately interpret local movements and can induce the retailer to profit by their true significance.

Wholesalers are not only assuming the responsibility of analyzing market conditions which affect the retailer, but they are, in many cases, also endeavoring to increase the internal efficiency of the retail store. This is being accomplished by giving suggestions for displays, fixture arrangement, advertising, and methods of handling customers. Some wholesalers are giving their clients accounting systems, and providing an instructor to install them and get them in running order. Demonstrations are provided, not only to convince the store's customers, but also to arouse the enthusiasm of the retailer and his salespeople for the merchandise. Such instruction in merchandising is one of the most valuable functions performed by the wholesaler, not only from the standpoint of the retailer, but also from that of society. Better merchandising means lower costs, and with the intense competition of the small stores fostered and kept in existence by wholesalers, the customer may expect to get the maximum of service with the minimum of cost.

CHAPTER IV

NEW TYPES OF WHOLESALERS

Manufacturing Wholesalers

Rise of Manufacturing Wholesaler.—If the wholesaler performed only those functions which have thus far been considered, the present system of distribution would present a much less complicated problem. The disturbing element in the situation has been a growing tendency on the part of the wholesalers to manufacture goods themselves, or, what amounts to the same thing, to control the factory output of manufacturers from whom they buy. Many other wholesalers in all lines have concluded that it was to their interests to put up goods under their private brand or label, and thus they have come to be competitors of their clients—the manufacturer whose goods they distribute.

The wholesaler maintains that the manufacturer is to blame for the development of this tangled situation. By selling to department stores, mail order houses, retail chains, and buying syndicates, the manufacturer has taken the cream of the wholesaler's business and left for the latter only the small buying units, the purchases of which bear a smaller percentage of profit in proportion to the expense involved in selling the order. The growth of new types of retailers has presented a temptation to the manufacturer which it has been difficult for him to resist. Larger direct orders were his for the taking, and naturally the wholesaler was not consulted. The wholesaler, being deprived of the profit which was attached to the portion of the manufacturer's output thus sold, was forced

either to content himself with getting a profit from the resale of the balance of the manufacturer's output, or to go into the manufacturing business himself and try to hold the market which he had created for his client's goods. The wholesaler maintains that self-preservation dictated that he follow this latter policy.

The manufacturer has felt forced to adopt the policy of direct dealings with large buying units, because the wholesaler did not create a satisfactory outlet for the manufacturer's goods. Moreover it is asserted that instead of pushing his goods, the wholesaler exerted his influence with the trade to substitute his own private brands for those of the manufacturer. By being closer to the retailer and in more frequent contact with him, such a procedure was possible—it could not be prevented by the manufacturer. With markets sluggish, or closed to his products, the only alternative for the manufacturer was to find his own markets; and fortunately the growth of new types of retailers, such as department stores and mail order houses, made such a direct connection not only possible but profitable. Having developed a selling organization to deal with these larger buying units, it was only natural to expand in order to take care of the smaller units, until at length the manufacturer found himself independent of the wholesaler's services.

Reasons for the Rise of Private Brands.—Either unconsciously, or by deliberately disregarding the consequences, manufacturers have helped to originate and further the marketing of wholesalers' private brands. This has come about in several ways. In the first place, a manufacturer may miscalculate the demand for his trade-marked article, and produce more than can be absorbed in his own market. In some cases it may be possible to carry over this surplus to the following season, while in others a large loss might result

from depreciation or obsolescence. Whichever is the situation, it is usually desirable to sell existing stock in order to liquidate capital for further manufacturing operations. Accordingly, manufacturers sell their surplus in bulk to wholesalers, who attach their own trade-marks or brands to these goods and sell them in competition with those of the manufacturer. The manufacturer feels that he has lost nothing by the transaction because his own brand has been protected, and he has at the same time liquidated sluggish stock.

In the second place, some manufacturers place their trade-mark only on goods of the first class. Imperfect goods are turned over to wholesalers to be branded by them and disposed of to the public, who are unaware of their origin. In lines where this policy has been followed to a high degree, wholesalers' brands naturally have the reputation for inferior quality. Many wholesalers' private brands are, however, of the best quality. In such instances as these the whole purpose of the trade-mark, viz., identification of goods, has been violated, and the customer is at a loss to know who is responsible for them. The manufacturer could market his "seconds" under a different trade-mark, but perhaps this would not be economical, since specialization in distribution is as much desired as in other fields.

In the third place, certain classes of manufacturers have no trade-mark of their own, but produce goods for wholesalers, mail order houses, and dealers, who assume responsibility for the product. Such a policy is often followed because it is the line of least resistance. A wholesaler offers to take the entire output of a manufacturer, to whom he assures not a fancy profit but a certain profit. Rather than to build a reputation for his product through a costly selling or advertising organization, the manufacturer accepts the easy method of sale and turns his yearly output over to the wholesaler. The chief danger of such a policy is that the manu-

facturer may place himself at the mercy of the wholesaler, and in case the latter should refuse to make the usual yearly contract for output, the manufacturer would be without a market. With a large plant on his hands and no market outlet, solvency cannot long be maintained. Many manufacturers, however, are willing to throw their lot in with wholesalers and mail order houses, hence the private brand becomes a deep-rooted institution in the marketing of goods.

Profit on Private Brands.—Non-advertised and wholesalers' private brands usually pay wholesalers a larger percentage of profit than nationally advertised brands. The advertising manufacturer justifies such a policy on the ground that he has performed part of the functions of the wholesaler when he has gone to the expense of making known to customers certain facts respecting the merchandise. With this selling information in the minds of customers, a larger and more spontaneous demand for the goods from retailers results, and this in turn is reflected in a more active demand for the goods which retailers make on wholesalers. The manufacturer, therefore, has taken over to some extent the function of creating demand, and he reimburses himself by allowing the wholesaler a smaller percentage of profit on each nationally advertised article.

There is naturally some opposition on the part of the wholesaler to the smaller percentage of profit allowed by the advertising manufacturer. The latter, in case he does not desire to assume the physical distribution of his own product, in order to be successful must get the co-operation of the wholesaler, which is usually accomplished by demonstrating to this middleman that greater total profits can be secured by selling the nationally advertised product, although the average profit percentage on each article is less than on some competing lines. Total profit is really what the wholesaler

is after, and a quicker turnover of his stock will produce this desired result even where the percentage of profit on individual sales is less than might be secured on non-advertised merchandise.

Protecting Consumer Against Private Brands.—The consumer is not necessarily injured by the distribution of private brands. If, however, the same goods are sold at one price under the manufacturer's trade-mark, and at a lower price under the wholesaler's brand, knowledge of this fact will prejudice the public against both brands. In reality there may be no sound reasons for prejudice, since the manufacturer may be able to maintain quality, reduce his overhead expenses, and improve his product, because of his ability to turn a loss into a gain through disposition of surplus stock to wholesalers.

Because of the belief that the interests of customers are injured by private brands, several attempts have been made to eliminate them by legislation. The most prominent remedy proposed is that the manufacturer be required to put his name on all merchandise produced by him. This, it is believed, would eliminate the private brand for two reasons:

1. Manufacturers would not want it known that they were producing goods for private branding which were identical with those bearing their own trade-mark.
2. Wholesalers would not want it known among retailers that they were not the manufacturers of the goods which they market as their own.

It is probable that neither of these supposed hindrances to the creation of private brands would prove effective. Considering the first proposition, the manufacturer could attach his name inconspicuously as compared to the name of the private brand, so that only those customers who bestowed exceptional scrutiny on the label would discover the actual

producer. The loss of good-will to the manufacturer because of this discovery by a small number of customers, would probably be more than offset by the gain derived from turning surpluses over to wholesalers for private branding. Even with the manufacturer's name conspicuously printed on the label, only comparatively few customers would realize its significance. Yet it must be recognized that in some cases such a legal necessity would undermine customer confidence and lose more than the gain that might come from selling this surplus to the wholesaler.

The second supposed result of such a law would be far less menacing than the first. Many retailers already know that wholesaler's private brands are not made by them. The prestige of the wholesaler is not necessarily at stake if the identity of the product is revealed. A brand should identify the one responsible for it, and not necessarily the maker. The retailer recognizes the wholesaler's responsibility in the matter and, as a rule, would not be prejudiced by antecedent identification. As long as the retailer can identify merchandise and place responsibility, he has no inclination to trace the goods any further. Putting the manufacturer's name on all articles of his production might lessen the prestige of the wholesaler, but it is difficult to see how this operation would prevent the wholesaler from continuing his present method of creating private brands from standard products of national reputation.

Private Brands and Large-Scale Distribution.—Several tendencies exist toward large-scale distribution. The wholesaler is tempted to manufacture his own private brand and substitute it for nationally trade-marked goods when selling to retailers. The manufacturer sooner or later senses the closing of his usual outlets for goods and welcomes the chance which the department store offers of selling direct. This gives the department store an advantage over its smaller competi-

tors and makes for larger department stores, since larger discounts are given with greater bulk purchases from the manufacturer. Unless the small store can develop advantages peculiar to itself, there is a definite and logical direction given to large-scale distribution.

This tendency exists not only from the standpoint of the retailer, but from that of the manufacturer. The latter increases his capitalization so as to include a sales organization, which must often be indefinitely expanded. The small manufacturer, with lack of vision of the market and ignorant of the means of selling direct and most advantageously is gradually eliminated, and the larger organizations which are independent of the wholesaler assume control of production.

This leads to the integration of distribution, since the manufacturer's output becomes so large that he must find outlets for his goods which are in excess of the department and retail chain store demand. He therefore creates a chain of stores himself, and by this last act controls the entire distribution of the goods from the moment they are produced until they are placed in the hands of the consumer. Similar to the integration which has taken place in production, a well-known example of which is the steel industry, is the growing tendency toward integration in the field of distribution.

The fact that manufacturers have permitted wholesalers to create private brands from their surplus or inferior stocks, with the result that they gradually have lost control of the market and have become dependent upon the wholesaler for the sale of their goods, has tended to force the manufacturer to sell direct to large buying units. Whether these large buying units are the result of this tendency or permitted this trend to satisfy itself, is a question difficult to answer. They are both probably cause and effect. The manufacturer would probably have worked out some co-operative measure with the wholesaler if no other outlet had been at his disposal; while,

on the other hand, the department store could not have developed the way it has if it had not possessed the advantage of buying at a quantity discount direct from the manufacturer.

Hindrances to Large-Scale Distribution.—What has here been said about the tendency toward large-scale and integrated distribution must not be construed to imply that this movement will continue at the rate at which it is now going. Public opinion, as reflected in our legislatures and the courts, impeded the progress of a similar movement in the field of production. If it can be shown that it is for the public interest to retard this tendency, there is no doubt that such a result will be achieved.

Another impediment toward the full realization of integration and large-scale distribution, is the combination of inherent advantages peculiar to the small retail store. Because of lower overhead expenses, and with potential efficiency in management and supervision, the smaller retail units may develop latent advantages peculiar to themselves which may go far to offset the advantages of large-scale buying enjoyed by the department store. If such is to be a future development, and there is much to indicate possibilities in that direction, the limit may be reached to the absorption of the retail field by large establishments, and as a consequence the manufacturer must rely more and more upon the wholesaler, since it has already been shown that where small stores exist it is uneconomical for the manufacturer to sell direct.

If the small store has certain inherent advantages over the department store, it may be asked if these same advantages do not inhere in the retail chain; may not the latter therefore displace the independent store thereby making the integrating process complete? In other words, large-scale manufacturing linked up with a large-scale selling force may sell to small stores in a chain owned by these manufacturers. Here would

be a case of large-scale production and large-scale distribution so far as the wholesaler's functions were concerned, but small-scale retailing so far as the physical establishments were concerned.

In answer to this question it may be said that the small independent retailer has certain advantages inherent in his establishment which are not to be found even in the small store of the chain. One preponderating advantage is the interestedness of the management. Another is the loyalty of the community. Whether these would be able to offset the chain store advantages, which involve better accounting systems, more systematic management, and quantity buying, is difficult to decide. It would seem from an investigation of the facts that the small independent store is not doomed if it can be made efficient. Many movements having widely varying sources are now at work to create this efficiency, and it is not too much to suppose that considerable success will result.

It is therefore seen that the problem of eliminating the wholesaler depends upon the changing character of the retailer. If large-scale retail units and the integration of other units are found to be more efficient distributors of goods than the small, independent stores, it may be possible for manufacturers to assume wholesaling functions and eliminate the present units that perform these operations. On the other hand, if the small independent retailer survives, the wholesaler will be necessary in order to supply him economically with goods.

Reasons for Retailer's Assuming Wholesaling Function.—Combining retailing and wholesaling functions under the head of a single organization has been brought about in some cases by the retailer, while in others the wholesaler has initiated the movement. Where the retailer has assumed the whole-

saler's function, the chief reason has been the desire to make a double profit. Another motive has been to develop a higher grade of service to his customers through making more accessible large and varied stocks of merchandise. The prompt delivery of newly produced goods is likewise assured. The retailer is thus enabled to develop a unique business which distinguishes him from competitors who do not enjoy the advantages offered by co-operative wholesale organizations. Even if no profit is made in the wholesaling end of his business, the retailer feels that it has paid for itself if it increases retail sales, establishes good-will, and assures a supply of merchandise that meets the demands of his trade.

Reasons for Wholesaler's Assuming Retail Function.—The wholesaler usually enters the retail business chiefly in order to insure a permanent outlet for his merchandise. With independent retailers forming buying syndicates; with the development of department stores which buy direct from the manufacturer; with the mail order houses satisfying a larger increment of the retail trade, wholesalers have felt the necessity of establishing direct contact with the consumer. This has resulted in chains of stores either owned or controlled by absentee owners or managers, and has presented another problem in marketing which is becoming acute in some communities. It has been found especially necessary for wholesalers to establish their own retail stores when the goods they controlled for resale have had characteristics which rendered them undesirable for the average retailer. Thus, slow-moving goods, broken lots, rare articles with large risk attached, and other goods of a peculiar character have been successfully disposed of only by control of the retail unit by the wholesaler. Another cause which has induced the wholesalers to combine retailing and wholesaling functions is a desire to establish service stations for retailers.

When a wholesaler assumes the retailing function, or vice versa, the wholesale and retail stocks are at first usually not separated, nor is there a separate organization for each. Accounts, however, are separated and someone may be appointed to handle the added line. As the new function grows in importance, segregation of goods and organization becomes complete. However, where wholesale and retail functions have grown up together in the same organization, differentiation has usually existed from the first.

Co-operative Wholesaling

Purpose of Co-operative Wholesaling.—As already indicated, the independent retailer has experienced within recent years keen competition from department stores, chain stores, and mail order houses. He has more recently come to realize that while he has some advantages peculiar to his particular kind of business, in order to survive he must secure buying advantages similar to those secured by these strong competitors. Since large buying power did not exist in each of the small retail units, it gradually became evident that the necessary and longed-for buying power could come only through co-operation of the small stores. Associations of merchants or buying syndicates were therefore formed in order to do for merchants collectively what it was impossible for them to do individually.

The savings effected by large buying power are several; among them is the ability to take up quantity discounts as wholesalers do. Better internal business management, and the elimination of part of the wholesaler's selling expense by maintaining a central warehouse, are also possible. Such profits of the wholesaler as are appropriated the co-operative buying unit distributes to its members as dividends, or lower prices of goods purchased.

Methods of Co-operation.—There are several different ways of carrying on co-operative wholesaling. One is for retailers to organize a buying syndicate, which buys in quantity lots certain lines of staples which they sell to the members for cash. The price represents the cost price plus administration charges. The usual profits of the wholesalers are, by this method, given to the members in the form of a lower price for the merchandise purchased. Usually the members of such a buying organization purchase only a small portion of their total stock in this way, only staples being handled.

A modification of this method has been made by some retail organizations which have established quarters in large manufacturing and distributing centers where manufacturers may display their goods for the benefit of member retailers who visit this exchange periodically. Purchases are made by members through a staff of expert buyers who are maintained by the co-operative organization. A closer touch with the market enables member retailers to purchase a wider range of merchandise than under the form of organization previously described. Even in this case, it is very often difficult for the co-operative organization to satisfy the exact needs of its members. A more exceptional form of co-operative wholesale organization is the incorporation of a body which performs almost the identical functions of the regular wholesale middleman. A warehouse is maintained, salesmen are employed, intimate contact is established with both manufacturers and stockholder retailers, and market information is made available to members. Any savings or profits accompanying the enterprise are paid to stockholders in the form of dividends.

Advantages of Co-operative Wholesaling.—In the first place, selling costs are usually low because the expenses of advertising and salesmen are minimized. The expense of

personal salesmanship is somewhat lessened because members order by mail, or call in person at the co-operative exchange. Mail order buying can be intelligently negotiated if the co-operative concern sends its members catalogues, price quotations, and accurate descriptions of market conditions or notice of special purchases from manufacturers.

Secondly, losses from bad debts are less than is the case with the old-line companies. This is the natural result of a policy of sales on a cash basis, or on very short-term credits—weekly or bi-weekly. The worst impediment to retailer co-operation seems to be overcome when cash payments are assured.

Thirdly, losses because of returned goods are usually smaller than in independent wholesale companies. Goods may be returned only for special reasons—usually when there is some defect in the merchandise. A retailer, being intimately associated with other retailers selling the same line of goods, may, however, be able to dispose of his excess stock through other members of the organization.

Fourthly, shipments direct from the manufacturer to the retailer (drop-shipments) may sometimes be arranged by the co-operative organization. The expense of sorting, classifying, and the like, is thus shifted to the manufacturer, so that the co-operative wholesaler acts merely in the capacity of a sales agent and collector. Such a plan, however, is possible only with those articles where small shipments do not materially increase the expense of the manufacturer. Members are also given the option of transporting their purchases from the wholesaler's warehouse, thus saving the transportation expense, or of having their organization do it for them and paying for it in the invoice.

Disadvantages of Co-operative Wholesaling.—Many obstacles must often be overcome in inaugurating a retail co-

operative buying organization. Antagonism is naturally exhibited by regular wholesalers, and every impediment is thrown in the way of its successful operation. Pressure is sometimes brought to bear on manufacturers to prevent their selling to such organizations, and if goods are difficult to get, membership becomes unstable. Furthermore, an organization of this character may have difficulty in demonstrating its permanence to manufacturers, for many organizations of this character have had but a limited span of life. With credit established, however, manufacturers are usually ready to sell goods to such syndicates, because a ready outlet is formed for their goods, without restrictions of private brands or middleman inertia.

Lack of loyalty to the organization is another stumbling block. When the organization fails to make advantageous connections with manufacturers; when merchandise secured by competitors cannot be secured through the syndicate; when errors in managerial judgment cause losses; and when some members are denied favors, disintegrating influences begin, which, unless counteracted, make for dissolution. The character and intelligence of the membership determines, to a large extent, the success or failure of the venture. Unfortunately, among the smaller retailers breadth of vision is frequently lacking, hence the co-operative movement has not developed as it might. With increasing competition from retail chains, department stores, and manufacturers' selling agencies, a community of interest must sooner or later arise among a growing number of retailers which will exhibit itself in more retail co-operative wholesaling associations.

CHAPTER V

THE DEPARTMENT STORE

Changing Methods of Retailing.—The development of retailing in the United States may be divided into two periods: that preceding the Civil War, and that following it. During the early period there were no department stores, chain stores, or mail order houses; all of these were the outgrowth of conditions following the Civil War. Goods were sold for the most part through general stores, although a few specialty stores had come into being in the cities where a wider market had developed.

Characteristics of Pre-Civil War Period.—Long credits were the rule and discount for cash was uncommon. Goods were purchased in large quantities, usually enough to last half a year. Style changes were infrequent. A wide variety of merchandise could not be purchased because the retailer's capital was tied up in large quantities of a few lines. The "variable price system" prevailed, i.e., the cost price was written in characters on the price tag, and the salesperson endeavored to charge as much over that amount as he thought he could get. This system of pricing goods led to the practice of bargaining, or higgling, the salesperson attempting to get as much as possible for the merchandise and the customer trying to purchase at as low a price as could be negotiated. Production of manufactured products lagged behind the demand for them, which condition tended to increase the number of retailers without increasing their efficiency. Competition was centered around price; service was secondary.

Competition was strong within communities and generated much community unrest. Merchants aimed at a long profit on each sale. Customers were outwitted by retailers and their salespeople wherever possible.

Characteristics of Post-Civil War Period.—In the period following the Civil War, these conditions of retailing underwent a marked change. Rapid fluctuations in prices made buying in smaller quantities necessary, which was made possible by the advent of the traveling-salesman system of distribution. Previously merchants had gone to market twice a year and purchased in bulk; now they could make purchases from six to twelve times during the year. This cutting down of the quantity of purchases led to a reduction in the length of time that bills were allowed to run, while discounts for cash became more and more the custom. Investing less capital in each line led to carrying more lines. Thus a greater variety of merchandise was on exhibition for the benefit of the customer, although only a small stock of each line could be carried at any one time. Increasing the variety made possible a greater number of sales in proportion to the capital invested than formerly, hence it was no longer necessary nor desirable to aim at a large profit on each sale, but rather at a small profit on many sales. In other words, the turnover became one of the most important phases of merchandising, a condition which obtains today.

Rise of the Traveling Salesman. The rise of the traveling-salesman system was contemporaneous with, and partly a cause of, the rapidly changing styles of this period. With the advent of this system, it became possible to purchase frequently in small quantities and thus satisfy the desires of large numbers of people for changing fashions. The distance in point of time between production and consumption was materially shortened, permitting and causing rapid changes

in styles. An element of uncertainty now arose in retailing that previously had not existed. Guesses as to style changes have made some lines, such as ladies' shoes, a precarious undertaking for the retailer. This new hazard has no doubt served to eliminate some of those unfit to adapt themselves to the new situation, and put in their place retailers who were adapted and fitted to forecast the desires of customers. Notwithstanding this fact, much loss of value in retailing is due to obsolescence of stock, which makes sale below cost necessary.

The One-Price System. A comparatively recent development is the substitution of the "one-price system" for the variable price system. Prices are now marked in plain figures, and apply at any one time to all customers. As a consequence of the growth of this policy, bargaining, or higgling over prices, in retail stores has become infrequent, thereby giving retail selling a dignity that previously was lacking. Customers began to have confidence in stores and expressed this new attitude by "shopping," which has become a pleasure for a great many women. Buying in retail stores lost its former combative characteristic, and with the disappearance of this attribute went much of the antagonism which has formerly existed between traders and consumers.

Emphasis on Service. Price gradually became a secondary attraction and service assumed the front rank in importance. This service first took the form of more desirable physical features, such as more attractive show-cases, commodious and well-arranged show-windows, artistic and harmonious lighting systems, and invisible lighting and heating apparatus. Later, service took the form of rapid and frequent delivery systems, the sending of goods on approval, restrooms, libraries, entertainments, and lunchrooms. Very recently, service *par excellence* has come to mean intensive cultivation of the human factor—the salesperson. Personal qualities, such as courtesy, promptness, cheerfulness, honesty, tact, and enthu-

siasm are taught salespeople. Instruction further developed and now embraces a study of the merchandise, human nature, store system and method. By such means, salespersons have in many stores become more efficient distributors of merchandise, and have tended to place retailing on a higher economic and social plane. In some cases they have come to be experts, and in a few instances, competent advisers.

Growth of Co-operation. Owing to the rise of the mail order house and the subsequent introduction of the automobile, competition from the outside loomed up in most of the small cities and towns throughout the United States as a menacing factor. In the effort to stem this invasion, merchants have come to realize that only by presenting a united front, is a chance for success assured. Old-time jealousies between retailers in the same community have thus been healed or forgotten. Efforts which have had as their end a betterment of local retailing conditions have become numerous, and competition between merchants has assumed features of co-operation.

Progressive Methods. One of the most important developments resulting from this new danger of outside competition, is a widespread movement among the retailers and the associations of which they are members to learn more about their business. Old rule-of-thumb or guesswork methods of carrying on retailing have been thrown aside by the more progressive, and others less inclined to follow their example have sooner or later been forced to recognize the merit of new methods, or go out of business. By natural selection, a new type of retailer has thus been developed who is characterized by open-mindedness and a desire to change as conditions change. From such men, demands for new merchandising ideas have been issued broadcast, and in response, young men of great promise have been attracted to the merchandising business; also universities have set aside appropriations for

merchants' institutes at which retailers can assemble and be instructed in the new technique by experts.

Retailing, revolutionized in these many ways, was still to undergo further important changes. The department store, chain store, and mail order house have modified materially our distributive system. Because of their importance and the scope of their development, each will be taken up individually; for it is only in the light of the development of these new types of retailers that present-day marketing can be completely understood.

Origin of the Department Store.—The origin of the department store has been traced to different sources. It is thought by some that it was an outgrowth of the general store which handled all lines of merchandise, but not in departments. According to this view, the general store was departmentalized until it gradually assumed the organization of the present-day department store. The fact is, however, that whenever the demand for a particular commodity would have warranted the formation of a separate department in the general store a one-line or specialty store was usually established which took over a large part of the trade in that commodity. Nor was the department store the result of a movement to combine under one management the numerous specialty stores that grew out of the general store, but of a movement to develop an entirely new organization on the plan of many specialty stores under one roof and controlled by one organization. These new institutions were made possible because of the growing pressure of production on demand. Manufacturers needed a larger and more independent outlet for their goods, and so were eager to foster the growth of the department store by granting quantity discounts and similar concessions. Purchasers, likewise, had long unconsciously desired a convenient place to purchase the many commodities of daily life.

The department store is therefore the result of a natural growth, owing to a multiplicity of forces that were affecting industry after the Civil War. The tendency to shorten the distributive process, the introduction of styles, the tightening of credit, the lower mark-ups, the small stocks, all tended to cause a new form of retail competition which brought into being the department store. More economies were needed, advertising was being introduced to stimulate demand, volume of sales was emphasized, buying strength was of primary importance. These same conditions led to the development of chain stores and mail order houses.

New Ideals of Store Service.—As regards store service, department stores have obligated themselves to perform functions which a few years ago were undreamed of. They have become amusement places for women, and recreation centers for their children. Some innovations are: restrooms, with reading and writing materials; cafés; ticket offices; postal stations; telephone booths; demonstrations; musicales; movies; and the drama. In some cases, department stores have gone into the commercial banking business, and have even acted as brokers for corporation securities. Playgrounds and hospitals take care of those unable to avail themselves of these advantages elsewhere. Except in isolated instances there is no direct charge for these services, and as a consequence the financial burden of carrying on the business is increased greatly. If, however, such attractions secure "volume," they are regarded by store managers as having performed a desirable function in modern merchandising, and are justifiable. The public demands such service and apparently is willing to defray the expense by paying increased prices.

The Buying Advantage.—Perhaps the most important advantage that the department store has had over its com-

petitors lies in its buying power, an advantage which was of more than usual importance in the years following the Civil War. In the first place, during this period rapid industrial expansion widened the market and made any forecast as to the nature and extent of the demand increasingly difficult for manufacturers, especially as the number of new competitors in each industry largely increased. This fact was conducive to miscalculations in quality and quantity of goods produced, and the only large outlet for surpluses of merchandise, produced as a result of mistaken forecasts, was through the department store. Hence the buying organizations of these institutions, with ready cash at their disposal, took advantage of the manufacturer's sacrifices and made bargain sales a prominent feature of department store business. By means of this advantage, department stores have created the keenest competition for small retailers to meet, and have, in many instances, forced the latter to form co-operative buying associations.

In the second place, the large increase in the production of merchandise during the last generation, due to scientific management and better technique, had led manufacturers to strain every nerve to find adequate and permanent outlets for their increasing production. As stated in Chapter IV, wholesalers were not ready or willing to push individual lines; the more aggressive manufacturers accordingly were willing and anxious to sell direct to any retailer who had good credit and who could buy in quantities formerly disposed of to wholesalers. As a direct result of this pressure, the department store came into being and offered a ready outlet for large quantities of merchandise. The manufacturer gave the department store a discount on quantity purchases almost equivalent to the per cent of profit formerly taken by the wholesalers. With a saving that varied from 5 to 15 per cent on standard merchandise, the department store could offer

bargains even when it was not able to pick up job lots or surpluses from manufacturers who had overproduced.

The department store has therefore enjoyed a steady supply of low-priced merchandise, and by bargain sales of these goods has purchased the allegiance of the average consumer. Whether or not the department store would have come into being if rapidly increasing production had not led to the demoralization of the old channels of marketing, is a question difficult to answer. Possibly some of the other advantages of the department store yet to be mentioned would have been sufficient to bring into existence this new form of retailing. However that may be, the department store has flourished as a direct result of the new circumstances pertaining to production, and has had an advantage over the small store which the latter has found it difficult to overcome.

Specialization of Functions.—The next important phase of department store efficiency is the high degree of specialization which has been effected throughout its organization. Whereas in the general store a salesperson sold goods in many departments, in the department store a salesperson sells goods in but one department. This narrowing of the selling area gives each salesperson the opportunity to become a specialist in a single line. While salespeople in department stores have not as a rule become experts, it is no doubt true that the basis exists for such a development, and that department store managers are looking forward to the time when salespeople will be trained to make full use of this opportunity. The public will then receive a character of service which it is impossible for the general store to give, because of its lack of division of labor.

Besides the specialization in selling, there is specialization in buying. Each department has its own buyer who is permitted to become a specialist, and eventually to develop into

an expert. Market conditions have become so complicated, and sources of supply so numerous, that buyers in order to be efficient must spend all of their time in one line of work. They cannot be efficient buyers for many lines—a duty which falls on general store managers. A further advantage of having an expert buyer in each department lies in the possibility of having him instruct salespeople regarding merchandise. No one is better fitted for this important task than the buyer, and the degree of expertness of the salespeople in his department will depend largely upon the buyer's knowledge and his willingness to impart it. This expert knowledge regarding merchandise is the most recent and important service which department stores are preparing to offer the public.

The department store organization is split up into many specialized organizations. It is, in a way, a combination of specialty stores. Accounts for each department are kept separately; departments must pay for themselves; general expense, such as light, heat, and rent are prorated among departments; and the buying and selling organization for each department is a distinct unit. In the department store—to contrast it with the general store—the accounting, advertising, handling of cash, and the like, are given over to a specialized department which serves all departments. This is a good illustration of the extent to which specialization in the department store has developed, and because of this elaborate subdivision of work, the department store can in no wise be compared with the old general merchandise store. Both are supposed to sell everything, but here the resemblance ceases. Specialization has transformed the department store into a fundamentally different buying and selling organization.

Economies Resulting from Combination.—A large saving no doubt results from having many departments served by

one accounting department, one delivery department, one credit department, one advertising department, one welfare department, and so forth. In other words, doubling the number of departments would not double the advertising, accounting, or other expense. On the other hand, increasing the number of specialty stores would no doubt make necessary duplications of these overhead expenses. Because of the possibility of distributing overhead expenses over more merchandise and more departments, department stores are enabled to charge a smaller amount to each department. One department helps another. Customers are attracted by advertising to purchase goods in one department, but before they leave the store they are attracted to another department where unintended purchases are made. In such a case, the advertising charge is spread over two sales instead of one.

The department store has an advantage over the specialty store in credit and collections. It is in a better position to extend credit on a sound basis because of its opportunities of ascertaining the nature of the risk. In cases where credit should not have been extended, the loss is usually less because of the strength of the collection department. More credit can be extended because the large store has more prestige than the small one, and customers assume that a collection power exists which in fact may not. The small specialty store must more often refuse credit or suffer a larger loss from bad debts. This advantage of the department store in regard to credits and collections is nothing more or less than the power to purchase customer buying-power. It amounts to an extension of business, which in turn tends to reduce the percentage of overhead levied against each department.

Department Store Rents.—In specialty shops that sell ladies' ready-to-wear apparel, the rent expense, provided the shop is on the ground floor, is greater than that charged

against a similar department on the second floor of a department store. Yet the sales in the latter may be as large or larger than in the former, depending upon the accessibility of that department and the extent of co-operation it enjoys from other departments. Other goods such as hardware, millinery, household goods, and children's clothing are usually sold on the ground floor in specialty stores, but are invariably to be found on the second, third, or fourth floor in department stores. A ground floor rental is at least twice that of a second floor, and sometimes more; the third floor is from a third to a sixth cheaper. Some department stores train their employees to suggest the purchase of goods sold on other floors, and if such extra sales can be made a distinct advantage accrues to the department store. By means of attractive ground-floor displays, persuasive advertising, co-operation among departments, accessible elevators, and obliging floor managers, a large proportion of customers entering a store may be induced to go to other floors; and it must not be overlooked that the lower prices due to lower rents may be the decisive inducement to the possible purchaser.

There is of course another side to all this matter. To assume, as is popularly done, that the department store can distribute merchandise at a lower cost than specialty or general stores is to go beyond the evidence. In fact, the cost-to-sell of department stores is usually from 2 to 10 per cent higher than for other types of stores. As regards rent, especially, even though some saving is made because of the utilization of inexpensive upper floors, it has been found that retail rents increase with the size of the city, and department stores are found only in the larger cities. In department stores, moreover, the ratio of rent to gross sales is higher than in specialty stores in the same city, probably because of the large amount of unproductive space that is given out to service features. Of course these service features bring customers to the store, but

they evidently do not produce a volume of sales sufficient to lower the percentage of rents to goods sold, to the general average for specialty shops.

Advertising Expense.—Advertising expense for department stores is usually more than that of specialty stores. It ranges from 2 to 5 per cent of sales while for the specialty stores it ranges from a fraction of 1 per cent to 3 per cent. The department store must spend a larger per cent of its sales on advertising because: it must draw trade from a larger territory; its competitors are more widely scattered and have the advantage of a knowledge of the whims of the very consumers the department store is attempting to attract; it must have a satisfactory volume of trade, and this volume can be realized only when a partial sale of its goods is made before the customer enters the store. Its size increases the interest of its news for customers, while the fact that it picks up job lots and special purchases necessitates the using of much descriptive advertising. In conformity with store service policy, this advertising must be attractively presented. The specialty store on the other hand may often be satisfied with the "name before the public" type of advertisement.

Delivery Costs.—The delivery for all departments is performed by one department, and it might be thought that as a consequence a large saving would result. In a sense this is true. In proportion to sales, however, the delivery cost for a department store is greater than is the case for other types. As might be supposed, this is due to the larger territory covered by the department store delivery service, and also to more numerous deliveries in the same territory. Customers have come to expect department stores to deliver inconsequential articles and to perform the service promptly. For advertising purposes the most up-to-date equipment is maintained,

hence depreciation and obsolescence charges are higher than is the case with other stores.

Ratio of Salaries to Sales.—The ratio of salaries to sales is generally about the same for the department as it is for the specialty store. Although the majority of salespeople are paid less than in specialty stores, the managers receive more. This alone, perhaps, would not be sufficient to explain the high level of wages in department stores. A further cause can be found in the waste arising through miscalculation in allotting salespeople to different tasks, and also in the lack of supervision which enables inefficiency to creep in and decrease sales. Owing to the high degree of specialization, a large amount of unproductive labor must be employed to do work, part of which at least might be done by salespeople at certain periods of the day if division of labor was not carried to such an extreme. For every person selling goods in a department store, one person is working behind the scenes. In the small specialty store, some of the scenery is shifted, so to speak, by the actors before they appear on the selling stage. In the department store, a separate force must be employed to perform work other than selling.

Gratuitous Service Costs.—Gratuitous service is the cause of much of the abnormal expense of the department store. Restrooms levy rent, capital, and labor expense against the overhead. The same is true with respect to concerts, style shows, playrooms, telephone service, checking service, railroad ticket service, taxi service, and the like. With competitors enlarging the scope of service and intent upon working out further ingenious ways of catering to the public, there seems no way to reduce expense in this direction. Service features attract customers to the store, and store managers seem to content themselves with knowledge of this fact. They feel

that service must continue to expand in the directions dictated by competition and public demand, and that any reduction in cost-to-sell must come from other directions.

Inefficiencies of Department Stores.—Generally speaking, the further away the financially interested proprietor is from the actual work that is being done, the greater the inefficiency of the work. Supervision by salaried floor managers is often of a high character, but it is not imbued with that vital interest which exists in the heart of the proprietor. There is much truth in the old saying, "The hireling fleeth because he is a hireling." Soilage, leakage, spoilage, breakage, and other loss of materials and merchandise are more likely to occur where there is no direct incentive to keep them down, and where hired diligence is substituted for the diligence of ownership. Some department stores are partially eliminating this waste by giving floor managers and department heads a financial interest in the business. This is no doubt a step in the right direction. In other cases employees are given a share of savings resulting from the employment of new methods which do not cut down the volume of sales. It is difficult to forecast the extent to which such methods of providing incentives to save will cut down the leaks. It may possibly be found that present-day waste is not a necessary evil of department store organization.

Many sales are lost because of low-grade salesmanship. As already indicated, the general run of department store salespeople get lower wages than those in specialty stores. The wages paid seem to reflect in most cases the value of the labor service purchased by the department store. The low-priced salesperson is usually a machine, an automaton who says, "Something?" and takes the money. The customer is given no individual service, and is often antagonized by some unintentionally senseless remark of the salesperson. The

specialty store prides itself on its ability to handle customers intelligently, and its efforts do not present the appearance of machine-like activity. Customers are addressed by name and their likes and dislikes remembered and catered to. They receive a genuine personal attention which may help to offset many of the gratuitously lavish services provided by the department store.

It is probable that this defect in department store organization is not fundamental and can be at least partially corrected. It has existed protractedly because department store managers have thought that the goods could be largely sold by advertising before the customer came into the store. Hence it was felt that a lower grade of salesperson could display the goods than would otherwise be the case. Lavish window displays, ingenious sales plans, gratuitous service, unusually prompt deliveries, and the geographic location of the store were also supposed to attract the customer, and to offset these expenses a saving had to be made in the sales force. Gradually it is becoming more evident to department store managers that all of these remarkable and costly incentives to the customer are wasted if the girl behind the counter antagonizes or exasperates the customer. If the wrong article is sold, or claims are made which cannot be substantiated, the store has a dissatisfied customer; and all of the extravagant advertising, show windows, and restrooms will avail nothing.

Educational Campaigns.—It is being realized, therefore, that high-grade salespeople are necessary to a department store as well as customer-satisfying forms of physical service. In line with this realization, department stores are making extensive plans to educate their sales force to serve customers adequately. This is no doubt a cheaper and better method of getting a desirable sales force than that of buying an efficient one ready-made. In the first place, the latter can

only rarely be found, and in the second place, the store can give the salespeople the training especially fitted to meet its peculiar demands. No doubt much money must be spent in this direction if the department store is to keep the lead that it has secured. This does not necessarily mean a higher overhead expense in any department or in the store as a whole. The probability is that the increased sales, resulting from greater personal efficiency, will more than absorb the expense of training salespeople.

It may be contended that as personal efficiency increases, salaries must increase, and thus the overhead must eventually feel the effects of such a policy. The answer to this is found in the attitude which customers hold toward salespeople who are looked upon as experts. Fewer questions are asked of such salespersons, less time is consumed in the sale, more sales are made in a given period of time; hence the cost per sale does not rise, and may more probably decrease. In other words, neither the customer nor the proprietor pays for the increase in salaries due to greater efficiency; the increase is paid out of the profit made on the excess of goods sold by the efficient salesman over the amount sold by the inefficient.

CHAPTER VI

THE CHAIN STORE

Origin and Development.—The chain store grew out of the disorganized economic conditions following the Civil War. Manufacturers were becoming dissatisfied because their increased production was not receiving a ready outlet through wholesalers. The middleman began to view advertising as a dangerous substitute for direct solicitation and accordingly took over some of the functions of the manufacturer by creating private brands. Chain stores grew up in response to the demand for them as evidenced by the manufacturer's willingness to give quantity discounts to any organization of retailers able to buy in bulk. In some cases, where chain store organizations did not grow in response to the need for them, they were created by the manufacturer; hence the latter became both wholesaler and retailer. In other cases, where the manufacturer succeeded in prevailing upon the old-line dealer to purchase direct, the wholesaler organized chain stores to form an outlet for his own brands. Or, as was sometimes the case, the manufacturer's chain store put the old-line dealers out of business, or diminished their importance, thereby dominating the market and forcing the wholesaler to form a chain of his own.

Moreover, this growing tendency of the manufacturer to give quantity discounts to retailers, and at the same time to create consumer-demand by means of advertising, has developed chain stores, other than manufacturers' and wholesalers' chains. In the first place, some retailers owning only one store have seen the economies resulting from quantity

purchases, and have added from time to time another store to their control. Usually this has been accomplished by the purchase of the business of a retiring retailer, or that of a "dead" storekeeper. These branch stores have sometimes been made independent units, while in other instances they have been operated in conjunction with the orginal store.

Some of the largest retail chains in the United States have been started by corporations especially designed to acquire, create, or combine retail stores. In other cases, the initiative in forming chains has come from the retailers themselves who have formed joint-stock companies, each retailer taking out a certain amount of stock in the new company and in return transferring his store to the new organization. In all cases the object has been to secure greater profits as a result of increased buying power, as well as to secure the advantages that come from combination of control.

Buying Advantages.—The wholesaler considers the chain store an especially valuable customer because of its ability to buy in large quantities, because of its financial strength, and because of the stabilizing effect it has on his outlet. In recognition of these desirable attributes the chain store is given by the wholesaler important concessions, one of the most common of which is "future dating"—dating the bill several weeks later than the date on which the delivery of the goods is made. This unusual extension of credit gives the chain store a material advantage over the independent store, which can get the discount only by making payment in ten, fifteen, or thirty days. By a quick turnover, such chain stores are very often able to sell the goods to the customer before they are required to pay their bills. Borrowing money at the bank in such cases is made unnecessary, and a saving in interest charges results. In many cases the smaller retailer's credit is such that he cannot borrow readily at the bank and there-

fore cannot take up his discounts. Under such circumstances, the small dealer is at a still greater disadvantage as compared with his chain store competitor.

Being the wholesaler's most valued customer, the chain store is given the benefit of secret discounts, inside prices, or confidential market information. Further, the chain store can employ a staff of buyers, who, by virtue of the preferential position of the company they represent, can locate bargains and new goods, and can make connections with sources of supply which are closed to the many dealers who are unable to seek them out and who could not profit by the information if they had it. Wider and more intimate market information is a prime advantage of the chain store organization.

When the chain store is not satisfied with such advantages as are to be had from purchasing through wholesalers, it goes over the heads of these middlemen and buys direct from the manufacturers. By so doing it is possible to absorb the wholesalers' profits, and to set a smaller retail price for merchandise and yet make a greater total net profit than the small independent store. Because of the possibilities of wide and more unobstructed distribution, if the chain is a large one with stores well distributed over the country, it may be a more desirable customer than the wholesaler, and because of this greater ability to market manufacturers' products, it may receive even lower prices than those quoted to wholesalers. As chain stores grow in size, they eventually reach this preferential position, and because of the buying advantage resulting therefrom they have come to be recognized as the most serious competitors of the independent store.

Selling Advantages.—In communities where competition is strong, the chain can lower prices in order to dispose of a competitor, and recoup itself for the loss incurred by raising prices in other communities where pressure from competitors

is not so evident. After competitors have been disposed of and the field is left to the chain, high prices can be introduced again without fear of loss of sales. Especially is such a policy workable where the community is isolated or not within easy reach of a large city. This ability to continue cutting prices indefinitely, gives the chain store a weapon which is perhaps the most dangerous in its possession. That many chains have not seen fit to exercise it, is no assurance that they may not.

The chain store is better able to cut prices than the independent dealer for the reason that the former has access to, or is the manufacturer of, private brands upon which it can fall back. On the other hand, should the chain purchase the nationally advertised goods traded in by the small retailer and sell them below their advertised price, the independent dealer would be unable to find other goods to fill their place and would be forced to discontinue business or to sell at higher prices. When such a policy is followed, the public gets the idea that the chain can sell more cheaply than its smaller competitors; or it assumes that the smaller retailers are attempting to secure too long a profit. In either case, the chain secures the good-will lost by the independent store, and increases its sales on other lines. The chain store has another interest in price-cutting. With the small retailer's goods discredited because of their sale in the chain store at a cut price, the chain can exploit its private brands. Many manufacturers have tried to prevent chains from cutting prices on their nationally advertised goods, but with so many contacts with the market afforded the chain, the manufacturer has found it difficult to enforce his ideas on the retail chain. The latter can get the goods, and with price maintenance declared illegal, the price-cutting will continue.

Advantages of Specialization.—The work of the chain store has been divided and subdivided until the most important

functions are performed by specialists who ultimately develop into experts in their particular line. In the case of the United Cigar Stores Company, real estate is handled by a subsidiary company. This work consists of the purchasing and renting of sites, the maintenance and betterment of property, as well as its subletting. Another company plans and executes window displays for all of the stores. Two other companies have charge of the agency and the premium phase of the business.

The small dealer, on the other hand, is usually inexperienced in his dealings with landlords and cannot drive such bargains as can the sophisticated chain organization. He selects mediocre locations, whereas, if he could have afforded an expert analysis of relative sites, he might have made other choices. The chain stores have made it a policy to investigate trade tendencies in the towns in which they plan to settle. They know the per capita consumption of their products and the number of people who pass any particular site the purchase of which is being contemplated. By such scientific analyses, guesswork has been largely eliminated and profits are assured wherever a location is determined upon.

The management of chains is usually of a higher character than that of the small independent store. This in many cases is necessarily so because the small store proprietor does not have sufficient trade to warrant division of labor. He is a jack-of-all-work in the store, selling goods on the floor, buying, writing advertising, keeping books, doing janitor work, and so forth. It is obvious that under such circumstances expertness in any particular line is impossible. The larger aspects of management become, for him, subordinated to everyday detail; his mind loses its freedom and ability to deal with large problems of changing trade conditions. From such conditions as these only mediocre service develops. Then, perhaps, an opening presents itself for a new kind of retailing

unit which is able to preserve the advantages of the small store and yet combine with them the efficiencies and advantages which come with large-scale operations.

Scientific Business Control.—The chain is controlled and direction is given to its energies by means of comprehensive and accurate accounting systems, which bring to light unprofitable commodities, leaks, and wastes, and determine accurate costs. The sales during different periods in any store and in all of the stores are readily accessible for comparative purposes, so that an incentive is given to each store to beat not only its own record but that of the other stores in the chain. By this method one of the greatest sources of inefficiency and decay in combinations is eliminated, viz., the weakening of competition. Each store is controlled by its own accounts, which are sent to the central office; and competition between the different stores is constantly active, because each store has access to the business statistics of every other store.

The business thus takes on the aspects of a game. Those who win their quotas are given bonuses or premiums. Encouragement to managers and employees is given out from time to time by means of house organs which give the status of each unit in the system. The highest efficiency is stimulated in order to increase the sales each year, and the handicap of having a hired absentee manager is thereby partially overcome. With a prize for the winners of the game, and accurate standards of achievement developed by accounting systems, a stimulus and control over each store is secured which means a minimum of loss with a maximum of sales.

Low Cost-to-Sell.—As compared with the independent store, the chain for several reasons has a low selling expense. In the first place, these stores can interchange any merchandise which is not moving. If one store has become stocked, for

example, with a line of shoes which is not popular in that particular locality, it can be exchanged for other goods or credit with some other store in which an outlet for the shoes may exist. Especially is this true where chains cover a large territory. It has often been found that what is not selling in Iowa will sell readily in Wyoming, and vice versa. Such an interchange of merchandise prevents mark-down sales, which are a loss to the independent merchant who, if bad judgment has been used in purchasing, has no other recourse than sales.

In the second place, many chain stores make no deliveries. Such a policy saves from 2 to 5 per cent on sales. When deliveries are made, there are usually requirements as to the size of the purchase, or an extra charge is imposed. As already indicated, the department store has multiplied indefinitely its delivery service, with a corresponding increase of the cost-to-sell. Independent small stores have tended to follow the lead of the department store. The chains, however, seem to have taken a definite stand against increasing expense through expanding this service, and during a period of rising prices, this obvious attempt on the part of chain stores to economize has attracted a great many customers whose incomes have not been keeping pace with the upward trend of prices. On the other hand, no doubt sales have been lost because certain customers do not want to take their purchases with them and are willing to pay the store for this service.

In the third place, standardization and the handling of the accounting and advertising functions by experts produce the maximum utility with the minimum cost. The same is true in granting credit and making collections. More care is exercised in extending credit, hence losses from this source are less than in the independent store, which is often eager to get more customers regardless of their ability or willing-

ness to pay. The chain store relies on its lower prices to attract customers, and refuses to extend credit except to purchasers having thoroughly established ratings. Likewise, in collections, the chain has a great advantage over the local independent store. The proprietor of the latter is well-known in the community and dislikes bringing too strong pressure to bear on delinquents. Such a leniency causes loss, particularly as losses generally increase in direct proportion to the time bills are allowed to run. The chain, on the other hand, is run by the manager from headquarters, and pressure of a determined or legal character is more imminent because no sentimental ties exist; consequently, customers will almost always pay chain store accounts before those of independents. A large number of chains sell for cash, thus eliminating all possibilities of loss through bad debts, which average, perhaps, ¼ to ½ per cent in independent stores.

The cost-to-sell is affected materially by the rapid turnovers which are characteristic of chains. It has been stated[1] that drug chains turn their stock from 10 to 12 times, as against 3 or 4 for independents; cigar and tobacco chains have a turnover ranging from 15 to 50, while for the independent the average is from 6 to 12; grocery chains have as high a turnover as 40 with an average of perhaps 25, whereas 12 would be considered about the average for independents. Such rapid turnovers have been accomplished by carrying small stocks and replenishing from week to week from a central warehouse. This policy has resulted in a smaller amount of capital tied up in each store than has been the case with independents, and the resulting capital charges have been less. This is true because the depreciation and storage charges on stored goods are less than on goods that are put on the shelves or counters of the store.

[1] *Printers' Ink,* December 17, 1914.

Chief Weakness of Chain Stores.—The substitution of a hired manager for the owner constitutes the most important defect in the chain store organization. The hired manager does not have the initiative, the incentive, or the same degree of interest in making the business a success, as does the owner of the independent store. He does not maintain the same close personal relationship with the employees as the proprietor. Loyalty to the employer, one of the most valuable assets of the small store, is generally lacking among salespeople in chain stores; the result being a half-hearted interest in the daily work and no incentive to better selling methods.

With hired management controlling the local business, system is designed to take the place of managerial initiative—a substitution which tends to deter men of large imagination from entering the field, especially as opportunities for advancement are limited by a constant tendency to cut down expense and centralize power and control. Consequently managers have to be chosen from the less efficient, who are apt to overlook opportunities to save expense, increase sales, and serve customers; hence it is a question whether the advantages that centralization gains on one hand, may not, on the other, be lost because of the lack of ability or the stifled initiative on the part of its store managers.

Heretofore the average of salaries paid to chain store employees was perhaps no more than those paid by the independent dealer—the large salaries of headquarters executives and supervisors being offset by the low salaries paid to managers and salespeople. With increasing competition from the rejuvenated independent, it is fair to suppose that better managers will have to be secured, which will mean higher salaries to managers. Routine and system are in fact, gradually being subordinated to strength in management, and with competition getting more and more on this basis, the independent is placed at less disadvantage.

Community Antagonism.—Another disadvantage that the chain stores have had to cope with, especially in the smaller towns, is the antagonistic attitude of the members of the community. The chain store has been considered an outsider which takes money out of town. To patronize it was to strike at local prosperity and help to satisfy the greed of "capitalists." In the beginning this antagonism no doubt originated from the merchants, but later on found its exponents in their friends and sympathizers. Those who traded at the chain store were considered enemies of the community, and business and social pressure were brought to bear on them for the purpose of inducing them to discontinue their patronage. The townsman has always been suspicious of the outsider, and this suspicion grew into antagonism when the outsider appeared as a competitor to familiar town interests.

This handicap is gradually being overcome by the character of the service given, and by reason of lower prices. Wherever the manager has been a good "mixer" and has been sympathetic with community projects, contributing store funds whenever other stores thought this policy desirable for the development of local prosperity, a change of feeling toward the outsider has appeared. This acknowledgment of local interests, linked up with square dealing and lower prices, has been the means of building up an increasingly permanent clientele.

Strangely enough, the energetic competition of the chains has served to increase the efficiency of some of the old independent competitors, and with a more progressive front presented to the customer from out of town, a reputation for being a live business town has come to some towns which a few years ago were losing much of their trade to near-by cities or mail order houses. Communities are therefore beginning to forget their antagonism toward chain stores, because they are learning to copy their strong points in their struggle

for existence. The chains are benefiting by the decrease of antagonism toward them; on the other hand, they are finding stiff competition where formerly there was disgruntled indifference. The increase of trade in such towns, owing to the heightened activity of the merchants and the inroads of newly progressive independents, will not tell seriously on the chains. When, however, the new trade becomes more completely absorbed, there will begin a competition between the independents and the chain stores that will determine which is best fitted to survive, or whether both can exist together in peace, harmony, and efficiency.

Future of the Chains.—As long as favorable conditions for the growth of chain stores continue, they can be expected to grow in numbers. As already indicated, the chief stimulus to their growth has been the dissatisfaction of manufacturers with the orthodox system of distribution, which has not afforded as rapid and wide an outlet for the increased production as was desired. That this situation will continue for some time to come seems quite evident. Apparently, relief can come to the manufacturer only by organizing a chain of stores of his own, or stimulating the creation of a store chain by others through the offering of quantity discounts.

Along with this tendency to form chain store systems, is a parallel tendency for chain store systems to combine or consolidate. This is not merely a coincidence but a case of cause and effect. The greater the number of chain store systems, the greater is the outlet for manufacturers' goods. The larger this outlet, i.e., the greater the competition of chain stores to purchase in quantity, the less desirable are the quantity discounts which are offered by manufacturers. In order, then, to get special prices, quantities larger than ordinary must be purchased. In other words, the quantity of merchandise that must be purchased if an extraordinary

advantage is to be secured continually grows larger. In order to be able to purchase larger quantities, larger organizations must be formed; hence the reason for the consolidation of existing chain store systems becomes clear.

An illustration of this tendency was the formation, in 1912, of the F. W. Woolworth Company, to take over the 5 and 10-cent business owned and operated by F. W. Woolworth and Company, 318 stores; S. H. Knox and Company, 112 stores; F. M. Kirby and Company, 96 stores; E. P. Charlton and Company, 53 stores; C. S. Woolworth, 15 stores; and W. H. Moore, 2 stores. Another example was the formation of the United Cigar Stores Company, which secured control of the Riker-Hegeman Company in 1913. Many other consolidations have taken place or are being contemplated. It is very probable, for some time at least, that large combinations will be found in the field of distribution just as they have come to occupy certain portions of the field of production.

The mammoth purchasing power of such chain combinations is worthy of an illustration. The manufacturer of a popular finger-ring, which retailed at 50 cents, was approached by the buyer of a 5 and 10-cent store chain who desired to make a large purchase of rings, so that they could be retailed at 10 cents. The manufacturer ridiculed the idea and said that he was selling plenty as it was—"more than 450 dozen a year." The buyer offered to take 60,000 dozen during the year if they could be sold wholesale to him at a price which would enable his system to sell them at 10 cents apiece and still make a profit. This stupendous quantity was produced by the manufacturer, who had thought that 450 dozen was a large quantity, and these gold-filled rings were retailed in the system's stores at one-fifth of their former retail price. In some cases, chains have purchased the entire output of furniture factories, and of other factories as well, thereby

securing merchandise at prices formerly considered impossible. With a larger output usually goes a lower cost per unit.

Future of the Independent Store.—The advent of the chain store was witnessed by thousands of failures among the small independent retailers. These failures were, however, largely confined to retailers who bemoaned the new competition and did not have the imagination to learn from the chains. The wideawake and progressive retailer need not go to the wall because of the new competition. The buying advantage of the chains can be offset to a large extent by the formation, among retailers, of buying syndicates. Many of the economies of the chains, due to large-scale operations, are not available to the small independent, yet the latter has certain advantages, such as community loyalty, personal supervision of employees, personal contact with customers, and a direct interest in the business, which it is difficult for the chain to secure.

One of the most important advantages of the chain, viz., a scientific accounting system, is available for the small retailer. In many instances the retailers are beginning to see the significance of this control. The rapid turnover, one of the secrets of chain store success, is too often only hazily realized by the independent. Adequate and well-written advertising, as well as well-decorated windows, are features which independents are rapidly adopting. In short, there are only a few advantages peculiar to the chain store, and it is doubtful if even the extensive exploitation of these advantages could bring about the downfall of the small independent store. The latter has its peculiar advantages which the chain is with difficulty striving to acquire. The probabilities are that independent retailers, when banded together in trade associations and instructed by experts in the best methods of advertising and selling, will in the future become most worthy opponents of the chain in the field of retail distribution.

CHAPTER VII

THE MAIL ORDER HOUSE

Retailer's Attitude toward New Conditions.—The mail order, or catalogue, house has grown out of conditions which existed a decade after the close of the Civil War. From the beginning of the nineteenth century up to that time the demand for goods had been increasingly greater than the supply, so naturally more attention had been directed toward the problem of producing goods, rather than that of satisfactorily distributing them. Small-town merchants had grown up in this enervating seller's market, i.e., a market where the advantage is with the seller whether he is the manufacturer or the retailer, and had never taken the trouble to study so much what the local market demanded as what the wholesaler had to offer. The consumer was more or less at the mercy of the merchant and took what the latter had on his shelves, instead of demanding specific brands or styles. The merchant's position was secure, and security bred contempt for changing conditions.

In the early seventies, as production began to catch up with demand, new conditions called for new marketing methods, from the manufacturer to the retailer. As indicated in the preceding chapters, manufacturers and wholesalers were beginning to adjust themselves to the new order. The retailer was more sluggish in his response. This was natural, since he was further away from the source of change—often isolated in remote country communities, and unconscious of the change from a seller's to a buyer's market. Accustomed to give customers what he had rather than to supply what

they asked for, the retailer continued his former policy; and consequently communities gradually grew away from their retailers and learned to look elsewhere for new articles or specific brands of old articles, which they were learning to distinguish and call by name.

Increased Facility of Communication.—When most communities were out of touch with the sources of supply of merchandise, the existence of mail order houses was out of the question. Even if the small-town merchant had not adjusted himself to changing conditions, he would not have been rudely awakened by the rise of mail order competition had not certain new means of communication developed simultaneously. These new methods of communication permitted the mail order house to reach thousands of isolated communities, and therefore may be considered as a condition of the growth of mail order houses rather than as a cause. The cause of the rise of the mail order house was the changing market equilibrium described in the previous section.

Perhaps the development of greatest consequence in the field of communication was the recognition of advertising as an important marketing device. Not only was this realized at about this time, but advertising possibilities were being increased by remarkable developments in photography, lithographing, typography, and the production of print-paper. Devoid of these improvements, the mail order house would be without its most essential weapon of attack—the catalogue. Given the catalogue, the mail order house was ready to perform one of the most important functions of the middleman, viz., the transmission of ideas regarding merchandise. A connecting link was now formed between the isolated farm house and the new source of supply.

Other conditions of communication were necessary before the mail order house could function efficiently. The catalogue

was of little use unless it could be brought to the consumer's home; this accomplished, prompt deliverv of orders was of prime importance. Prompt delivery was dependent upon freight, express, and mail service. With the wide extension of railways in the seventies and eighties, followed by a reduction in freight rates; with the expansion of the postal service, culminating in rural free delivery and cheap postage; with the growing facilities of express companies, and finally the establishment of the parcels post system, has gone a corresponding growth of mail order business. Every means of getting in touch with consumers has been put to advantageous use by this new type of retailer, and no doubt the mail order house has helped to stimulate the demand for better means of communication.

Character of American Communities.—Another element necessary for the growth of the mail order house is found in the character of the average American community. While in Europe a community has usually meant a group of town and country people with common interests, the community in this country has come to be regarded as not inclusive of the country surrounding the town. This is partly owing to the fact that country people have not felt that their interests were identical with those of the town people and that a "loyalty" was due to the town about which their farms were grouped. Very often a distinct antagonism between town and country has been noticeable. Hence country people have experienced no compunction in buying from mail order houses when the opportunity was afforded.

This aloofness of our country people has been caused by natural conditions. Farms have been large and opportunities for social intercourse between town and country people have been few. Not meeting often on a common ground, or working together towards a common end, these

two groups have grown apart, and reciprocally ignorant, each has become suspicious of the other. Only too often this delicate situation has been intensified by the rough service accorded country people by retailers and their salespeople. In a survey made of the economic and social conditions in a township in the state of Iowa, it was found that 30 per cent of the people traded almost exclusively with mail order houses, and that an equal per cent purchased part of their goods from this source. When asked why they did not purchase in their neighboring town, several reasons were given, but among the most often repeated was this: "The town people think that they are better than we are."

No doubt the farmer is likewise somewhat to blame for the chasm between country and town. He has not taken part in town activities and has driven in only because of a special need. Even then, he has often been surly and critical of merchandise, and has objected to prices. He has let his bills run for periods of not only months but years. He has allowed himself to become an absentee member of the community until he has been considered an outsider with different interests. Both town and country have been to blame for the lack of harmony; but both have been pioneers building a nation, and too busy to notice the character of its structure. At any rate, this lack of a community of interests was favorable ground for the introduction of the mail order business, which was welcomed by many thousands of country people as a means of emancipating them from the tyranny of the town. Hence the mail order house has aggravated the former situation and made the farmer more independent and conscious of his rights and power. Where he has become independent of the town retailer he has not been backward in saying so.

Character of Mail Order Service.—From what has been said, it is to be presumed that the mail order house is supply-

ing a service, or a combination of services, different from that offered by the local merchant. These services, or distinguishing advantages, constitute a new chapter in the history of retailing, and form significant points of departure from the system of retail distribution which existed from the time of the settlement of this country. They are strictly American in character, and are therefore peculiarly adapted to new world conditions. As conditions change, a gradual modification of these services is going on, but for the last generation they have characterized a new system of retailing which has been gaining strength with each decade.

1. **Wider Variety of Merchandise.**—In the first place, the mail order house affords each customer a scope of selection which is far beyond that which the country merchant can offer. The latter, in his general store, has to keep a little of everything, but he cannot afford to tie up his capital in a large variety of any one line. The same is true to a more limited degree in the small-town one-line store. In the case of shoes, for example, there would be little inclination on the part of the proprietor to depart very far from staple lines, although he might be convinced that there would be some demand for other varieties. In order to keep in stock a satisfactory variety of sizes in the more staple styles, the proprietor's private capital is generally completely exploited, as is also his command over credit. Those customers who desire to pick from a large stock are therefore usually disappointed. Very often the merchant realizes that this dissatisfaction exists, but he feels that he cannot lessen it.

This limitation of the local store has not diverted country trade to mail order houses so much as town trade. In the towns even the wives of merchants handling ladies' ready-to-wear apparel and other lines have sent to mail order houses for their goods. It has never taken long for a lack of confi-

dence in the local store's merchandise to spread, until a large percentage of town trade has gone to mail order houses. In such cases, the town merchant has been discredited by the exercise of a powerful human instinct—the instinct of imitation.

If townspeople merely sent out of town for goods which are not on display in local stores, a comparatively small amount of damage to town trade would result. Once embarked in sending mail orders, however, the housewife has enlarged her order to include many articles which formerly she had no intention of buying elsewhere than in the town stores. Gradually the habit has developed, until in some towns large numbers have come to make a practice of sending away for merchandise that is to be found on the shelves of stores within three blocks of their homes. After such orders have been sent, the housewife feels that the merchants know what she has done, and she is even more loath to go to the local store for articles which she never intended at first to buy from mail order houses. Thus the situation is aggravated, and distrust or open antagonism is developed among citizens of the town.

2. **Low Prices—Loss Leaders.**—The mail order houses have followed a consistent policy of creating the impression that their prices are lower than the prices asked for the same goods in local shops. For many years the mail order catalogue has listed its prices opposite "store prices" (often fictitious), thereby subtly prejudicing the consumer against goods distributed through stores. Recently, the Federal Trade Commission has issued an order against this practice on the grounds of "unfair competition," and it would seem that the mail order house has lost a distinct advantage with the passing of the privilege of price comparison.

The impression of universally low prices has also been

successfully instilled in consumers' minds by the liberal use of loss leaders. Well-known brands, like Winchester (rifle), Ingersoll (watch), Big Ben (clock), and Victor (top), have been prominently displayed in mail order catalogues at prices below the widely advertised prices fixed by the manufacturer. Customers have reasoned that if these well-known articles could be sold at lower prices than are customary in stores, other less known goods could likewise be sold below store prices. Unfortunately for the customer, his assumption in this respect has quite frequently been false; the higher prices at which he has purchased obscure brands have offset what he has saved on the well-known loss leaders.

The use of loss leaders has not been an advantage of the mail order houses exclusively, but they have made use of this selling device so thoroughly and systematically that it has come to be considered a part of mail order policy. The larger retail stores, for the most part, have used loss leaders as consistently as mail order houses, but the small store (the mail order house's weakest competitor) has been negligent in meeting the prices of outside competition. The latter class of dealers has apparently thought it was good merchandising to attempt to procure, so far as possible, a uniform percentage of gross profit. Their failure to accomplish this end indicates that good merchandising requires first of all the meeting of competition, and, in the last analysis, this means the supplying of what the customer wants, at a price, time, and place which are most convenient for him.

Low prices may be more than a pretence. They have in many instances been attained because of certain economic advantages peculiar to mail order organizations. In some cases the output of whole factories has been purchased, while in others the factory itself has been brought into the mail order organization. All of the advantages of large-scale distribution, and even of integration, have tended to lower the

per unit distribution cost. Yet these advantages are not absolute; they may be more than offset by certain existing disadvantages which have always begun to operate as soon as competing stores have realized their own elements of strength.

3. **"Different Goods."**—A third characteristic of the mail order house which gives it a preferred position in the minds of numerous country people, is its ability to offer goods different from those found in the average country general store or small-town specialty shop. It seems to be a fundamental trait of human beings to desire that which will distinguish them, give them individuality, or set them apart from their fellow-men. General stores have adhered to staple lines for the most part, and have therefore ignored rather than played up to this human instinct. It remained for the mail order house to satisfy this underlying demand and liberate large numbers of people from the hampering uniformity of local conditions.

Irrespective of how much this liberation was desired, it could not be realized until certain economic conditions had been changed. Since the early days, the farmer had been dependent for credit upon the country store. Bills were paid twice a year, or even once a year, depending on how crops were sold or live stock marketed. The farmer could not purchase from mail order houses because he did not have the cash, and he had no established credit with them. He was therefore forced by conditions to purchase all of his goods through local channels, even though he might prefer goods from other sources. With rising prices of farm produce, however, and greater economy of production, owing to farm machinery, the farmer's standard of living began to rise and yearly savings became possible. These savings, together with the rise in land values, gave the farmer ready cash or credit

and this, in turn, had the tendency quickly to emancipate him from the necessity of purchasing his goods from dealers in his own community.

Not only was there an underlying demand for different goods; there was also a demand for an opportunity to shop—to appraise competing values. City people were enabled to gratify this desire by reason of the large stores which were established in large centers of population. This advantage, however, was not to be found elsewhere. Large portions of the country's population were unable to see and hear about the modern appliances and changes in styles which have come to dominate people's minds during the last generation. The mail order catalogue opened a closed door for millions of people and gratified their desire to shop. This was the best substitute for city shopping which had heretofore been devised. It was instantly successful. The justification for its initiation and continuation rested on the ground of satisfying a demand. Its success will last only so long as it continues to perform this function.

4. **Definite Merchandise.**—A fourth advantage of the mail order house has been its policy of creating definite values. This has been accomplished by accurate descriptions. Whereas the smaller stores have been content with giving superlatives and generalities which confused rather than created values, the mail order houses have spent much time and money in working out the values of their goods and presenting these facts in a clear-cut, intelligible manner. They have apparently realized that value has not been created until it has been created in the minds of the ultimate consumers. The poor salesmanship of many stores stands out quite noticeably when compared with the descriptive selling appeals of the catalogues.

How mail order houses create definite values by means

of accurate description is illustrated by the following advertisement of an incubator: [1]

> Imperial Incubators have cases of select California redwood which will not warp. The walls are double and thoroughly insulated. Cases are put together in a special way which prevents joints from opening up under damp conditions or long usage, a very important point. Doors are double and snug fitting. Glass windows in doors permit inspection of entire egg chamber. Egg trays very strongly made and will not sag. The sizes over 120-egg have two trays. Chicks drop down into warm nursery under tray when hatched. The regulator is entirely automatic and controls heat perfectly. The thermostat which operates the regulator is the very latest expanding water type. High-grade thermometer and lamp with each machine. Steel heater parts are enclosed in special chambers within incubator case, conserving the heat. Patent egg-turning rack furnished at small extra cost. Turning rack reduces capacity of tray about one third. Imperial Incubators furnished with either hot air or hot water system. Satisfaction guaranteed.

Hardly comparable with such a definite description of value, is the advertisement which appeared in a country newspaper not long ago:

> Now is the time to think about incubators. Come in and see our complete line. John Smith and Company.

A certain farmer confessed that the reading of this advertisement stimulated him to think about incubators, but since there was nothing to think about in the advertisement, he sought the mail order catalogue where he read the description just referred to. Not being able to take the time to examine the incubator in the town store, he ordered one from the mail

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[1] Sears, Roebuck and Company, catalogue, 1918.

order house. Many similar cases could be cited to show how defective advertising and salesmanship in stores have been the means of turning business to mail order houses.

Appeal to Imagination. Mail order salesmanship has not been content merely with describing merchandise, it has appealed to the imagination of the customer and has pictured the merchandise being used by him. The advertisement of a certain mattress illustrates the point: [2]

> This mattress is smooth, even, springy, as soft and buoyant as a feather pillow. Made with a smooth, even surface, no tufts of any kind being used, it fits itself snugly to every curve and line of the body. You do not rest upon the "high points" as with the ordinary mattress. This provides absolute relaxation for every muscle—producing the most restful, refreshing sleep.

On asking to look at mattresses in several stores, the writer was told that they were: "good values," "the best made," "the best sellers," "guaranteed to give satisfaction," "great stuff," and "well-made." Glittering generalities prevailed, and any attempt to create a conviction of value in the mind of the customer was lacking. The glib use of worn-out words and expressions took the place of specific, tangible, valuable information, which alone makes intelligent buying possible. In a very ineffective manner, an attempt was being made to sell mattresses, while the mail order house seemed to realize that the mattress was only a means to an end, and that end was "restful, refreshing sleep." In other words, the selling of a certain kind of sleep was the prime object of the mail order salesmanship, and because of this visualization of the customer's interest, it was the more successful of the two methods.

It may be said that the mail order houses are forced to

[2] Sears, Roebuck and Company, catalogue, 1918.

use minute and accurate descriptions of their merchandise because they cannot show it, while such a method is unnecessary for the average store, since the customer can handle the goods and ascertain their value to his own satisfaction. The fact remains that people only see that which they are educated to see, and unless value is created in the mind of the customer, it very often does not exist at all. It is probable that in their minds many customers see and recognize the value of some mail order merchandise more clearly than with their eyes they would see the form and value of similar merchandise if it were placed in their hands in some store. In other words, the mail order goods often "look better" to the customer than do the goods being sold in stores, when, in reality, the difference in intrinsic value between them is negligible.

5. **Service.**—A fifth advantage of the mail order house is found in its ability to give certain kinds of service which are demanded by an increasing number of people, and which have been overlooked by many stores. One of these is courteous treatment. In thousands of stores customers are never thanked for the business which they bring. They are never made to feel that their trade is appreciated. They are treated with gruff, overbearing, ungraciousness which gradually lessens their good-will toward the store. These dissatisfied customers experiment with mail order buying and generally find what they have been craving—kind, courteous, sympathetic, and human treatment. The demand for this kind of service may never have been conscious, but it has been a demand nevertheless; and its satisfaction binds the possessor of the demand to the source of this satisfaction.

A mail order letter usually starts out with: "Your valued order of the 10th received." Then it goes on exhibiting appreciation of the order; explains that above all things the mail order house desires to give satisfaction; gives special

information of value to the user of the article; and finally, definitely thanks the customer for the order and thereby keeps the trade channel open for further business. The customer's interest is kept paramount, and if there is any controversy, the customer is usually permitted the benefit of the doubt. In fact, the largest mail order house in the country allows all customers' claims under a certain amount without investigating their validity, as it has been found by experience that most customers are honest; where the opposite is true, what would be saved is more than offset by the expense of investigation.

Cheerfulness, Tact, Enthusiasm. Besides courtesy, the mail order houses inject cheerfulness, tact, enthusiasm, and other positive qualities into their correspondence. The customer feels that he is dealing with somebody, and not merely with something. The mention of his name in the letter individualizes him, and flatters him in a subtle manner. How often in stores is he merely one of many customers to be grudgingly "waited on"? How often does he wait while salespeople carry on their gossip and tell their little stories? How often must he stand around, growing impatient, while the proprietor or his salespeople finish their tasks of sorting goods, cleaning or inventorying stock? After seeing the service, or lack of service, in many of our stores, it is little wonder that many people prefer to send by mail for goods, even though their coming will be delayed by the exigencies of express or freight service. They at least know that any delay in arrival will be to causes beyond the control of their favorite mail order house. They figure on a lapse of time before arrival, and therefore are not disappointed because they cannot get the goods immediately.

Notwithstanding delays, misunderstandings, and a great deal of inconvenience incident to ordering by mail, many people feel that these are small matters compared with dis-

courteous treatment in stores. When the customer is offended by an organization, he will go to almost any extremes to cease trading with it and to buy from one that pays him reasonable deference. Many disagreeable features may characterize the newly formed trade relations but the customer will overlook these if they do not infringe upon his self-respect. Many stores are realizing this weak spot in their organization, and are instructing their salesmen how to handle the customer so as to give him satisfactory service.

6. Guaranty.—A sixth advantage of the mail order house is one not merely of facilitating the sale of goods, but of keeping them sold. The prominently displayed guaranty of one mail order house reads as follows: "We guarantee absolute satisfaction. Promptly return to us, at our expense, any unsatisfactory purchase. We will then either exchange it for what you want, or return the full amount you have paid, together with transportation charges." People know that this guaranty means just what it says, and confidence is built up in assertions which have no means of immediate verification. Risk is minimized and value enhanced. Skeptical customers become convinced that there will be no chance for future regrets if they place an order. Goods which would otherwise with difficulty be sold, such as those requiring matching of colors, accurate fitting, and the like, are purchased without so much as a second thought.

When the merchandise is not exactly what was expected, or when it does not meet the needs for which it was intended, the guaranty produces an interesting psychological situation which tends to minimize returns and exchanges. The guaranty is such a positive assertion of the value of the merchandise that the customer is led to believe, even against his better judgment, that it is all right in spite of his fears to the contrary. In other words, when it is made easy to return

merchandise, customers in most cases feel that it would not be to their advantage to do so. But when difficulties are thrown in the path of returned or exchanged goods by retail stores, the customer feels that it is to the advantage of the store to prevent such returns and exchanges, and hence it must of necessity be to the disadvantage of the customer.

Creating Demand.—While stores in many cases have been satisfied with merely taking orders and only haphazardly displaying their merchandise, mail order houses have taken the initiative and sought to create demand for their products. Labor saving devices, new appliances, modern inventions, improved equipment for home and farm, efficiency devices, and hundreds of other general classes of articles have been held before the customer's eye until he has extended his standard of living by purchasing them. By following this aggressive policy, the mail order house has been enabled to increase its sales, when retail stores were standing still waiting for customers to call and "ask for" the goods that were being carried by the mail order houses. Numerous cases are known where customers have told of the wonderful "new" article they were able to buy at a mail order house, when investigation showed that the same or a similar article had been occupying the shelves of a near-by store for months and even years. Stores have not pushed new merchandise as they should, and have only too often become the purveyors of staple commodities which require little effort to sell. Here, again, the mail order house merely came forward and satisfied a demand —by creating a demand for the out-of-the-ordinary.

CHAPTER VIII

THE MAIL ORDER HOUSE (CONTINUED)

Economies of Operation.—By satisfying a demand which the local merchant had ignored, by supplying commodities with distinctive qualities and at professedly lower prices, the mail order house has come to enjoy six outstanding advantages:

1. It is equipped with unusual buying power.
2. It often can avail itself of secret discounts.
3. Its cash policy insures it against losses.
4. Its charges to capital expense are less because of its rapid turnover.
5. It specializes its managerial functions.
6. It can sell its goods in a world market.

As the present chapter develops, it will become clear that the advantages of the mail order house are very largely the disadvantages against which the local merchant has to contend.

1. **Unusual Buying Power.**—Because of its size, the mail order house is often able to buy up the entire output of a factory. With all the worry of marketing his product removed the manufacturer is willing to make a price which insures him his costs, plus a small net profit. If his risks and costs of marketing were greater, he would have to ask more for his product. Where a large supply of goods cannot be secured at a less-than-the-market price, the mail order house may purchase a factory that is unable to operate successfully, or it may build its own producing plant. In either case it obtains

a supply of merchandise through avenues which, to many thousands of stores, are unavailable.

Another source of cheap goods is daily discovered by an army of buyers who keep in touch with manufacturing conditions all over the world. These men make it a business to know: when any manufacturer has overproduced; when any manufacturer needs money; when jobbers are narrowing the market for certain products; when changing demand will produce obsolescence; and when many other conditions may arise to permit bargains, reductions, or special prices. These business scouts are bound to no rigid or customary channels of supply, as are many retail stores. They are free-lance buyers and shop before they purchase mail order goods.

2. **Secret Discounts.**—In some cases, the mail order house has been able to buy more cheaply than competitors because of secret discounts. This is a form of unfair competition and has been vigorously fought by jobbers and retailers. Organizations of these latter middlemen have been formed to boycott manufacturers who carried on such a practice. Where it has been impossible to get evidence of secret discounts, but where it was strongly felt that they were given, retail organizations have refused to buy the manufacturers' products, and the latter have suddenly realized that 90 per cent of their market had disappeared and that their only customer was the mail order house which now was demanding further concessions as the only basis for increased purchases. Because of the fear of what retailers will do through their organizations or jobbing associations, many manufacturers will not sell to mail order houses and endanger perhaps nine-tenths of their business for the remaining one- or two-tenths. The source of supply of some products is not open to mail order houses to such an extent as it is to stores, but the number of these unavailable products is small.

3. **Safeguards from Loss.**—By adhering largely to a cash policy, mail order houses have been saved from the burden of bad debts, which is often a fatal handicap for the small store. Along with this advantage has gone the simplification of keeping accounts, as well as the accumulation of large funds of cash which can be used to take advantage of daily market conditions. Where credit has been extended on larger purchases, such as pianos, furniture, and machinery, the risks have been previously carefully investigated so that the chances of loss were small. A vigorous collections department keeps credit customers posted as to the date payments are due, and failure to meet payments brings follow-up letters at regular intervals which become more determined in tone until payment is made or suit is commenced. Even with these safeguards some losses result, the average for mail order houses of all types amounting to about 1 per cent.

With the average small retailer the loss through bad debts is often two or three times this amount. Where the retailer knows his customers personally, he is often reluctant to send bills for fear of offence. Bills running from six months to a year are not uncommon in some farming communities, although since the Great War the tendency has been to shorten credit. In the stampede for more customers, credit is often extended without any previous investigation as to willingness or ability to pay. Because many communities are without a credit-rating bureau, it is possible for credit customers to incur obligations at one store until their credit is shut off, and then proceed to the store across the street and perform the same process. Besides these disadvantages arising from the misuse of credit, from 10 to 50 per cent of the gross sales are represented in the ledger instead of in the cash drawer, and the store is handicapped in taking up its discounts, or in assuming advantages that the immediate market may afford.

4. **Rapid Turnover.**—The charges to capital expense are reduced materially owing to the rapid turnover of goods. Sometimes the larger and more expensive goods, or goods of special make or design, or merchandise infrequently called for, have not yet been manufactured when the order and accompanying cash arrive for their purchase. Hence the raw materials and labor cost which go into the product may be paid for with the customer's money before the product is manufactured. In other words the customer is made to supply the manufacturing capital, instead of the mail order house. Or it may be that the article ordered has been manufactured only recently and is stored at the place of the manufacturer. If such is the case, the article can be shipped direct from the factory, thereby saving transportation charges from the factory to the storerooms of the mail order house, and lessening the time during which capital charges would operate. Of course large volumes of merchandise are stored at the central warehouses, but these are constantly kept moving so that capital is tied up in a commodity for the shortest possible period before it is sold. Capital, as well as the other factors of production and distribution, is made to operate efficiently.

The tendency for smaller stores has been to purchase merchandise in quantity lots because of special discounts or other inducements that were offered. This policy has served to tie up the limited amount of capital available, and has made impossible the carrying of a larger variety of goods. When the purchases have been unchanging staples, no further loss has resulted; but instances are common where large quantities of certain articles have been purchased only to become "stickers," by reason of the changing character of demand. One merchant was found to have several shelves full of fancy kerosene lamps, although his community had had electricity for ten years. He was inventorying them at full value and kept them displayed in a prominent place in the center of

the store. Another store had a large number of ladies' cloaks which had accumulated during seven years. They had been purchased in dozen lots instead of lots of two's and three's. In the larger stores, the small purchase and quick turn has been common for years, but the small store still adheres to a buying policy which handicaps it in its competition with the mail order house, the department store, and the chain store.

5. Specialization of Management.—The mail order management makes great savings through specialization of functions. Each duty is divided and subdivided so that the performer may become a specialist. Matters of routine are directed through specialized subordinates, thereby giving those with managerial ability an opportunity of seeing the broad aspects of the business, and the time to plan and work out more economical methods of procedure. On the other hand, it is a common sight in a retail store to see the proprietor sweeping the floor, opening crates, decorating windows, waiting on customers, buying goods, or doing the hundred and one things which have to be done in the average store. In some cases the business is not large enough to permit of anyone's time being occupied in only one phase of merchandising, while in other cases the proprietor has fallen into a rut and is performing manual duties and detail operations which could be turned over to those less qualified for management.

Besides specialized management, the mail order house has the advantage of a higher grade of management. It can employ the best men to fill positions of responsibility. These men, having greater foresight, ability, and judgment than the small retailer, naturally see ways of improving their advertising, selling, buying, and general direction of business, all of which is a closed book to those less well endowed. In merchandising, as in almost every other form of business, there is a competition of brains. The department stores and

chain stores are equal competitors with the mail order houses in this respect, but the small retailer very often does not have the training or the ability to cope successfully with rapidly changing and complex market problems.

6. World Markets.—By selling goods all over the world, the mail order house is independent of local depressions or catastrophes. It is not vitally affected by local boycotts, and movements against it have difficulty in spreading to unaffected districts. Its buyers take advantage of the differences in the prices of raw materials in widely separated markets, since the trend of events over a wide area is discovered in time to make successful adjustments. Such elimination of uncertainties makes possible a more intelligent use of capital and provides a basis for broad planning. The local business is always at a disadvantage in competition with the nationally and internationally conceived institution.

Cost-to-Sell. — Notwithstanding the many advantages accruing to the mail order house, the cost-to-sell (often known as the cost of doing business) is much the same as it is for some kinds of specialty stores. For the mail order house it averages close to 23 per cent, which is explained by the fact that one item, advertising, is very much higher than in the average store, amounting in some cases to 10 per cent and seldom falling below 6 per cent. The advertising expense for the average store is, perhaps, not more than 1 per cent. In small stores it hardly ever amounts to more than ½ per cent, while in the larger concerns 1½ per cent is usually considered a liberal appropriation.

Comparisons of the cost-to-sell of mail order houses with stores carrying certain lines of goods are as follows: the mail order cost-to-sell is about 5 per cent higher than the average grocery cost-to-sell; it is about the same as that

of dry-goods, ladies' ready-to-wear, furniture, and shoe stores; it is 1 or 2 per cent higher than that of hardware stores; 4 per cent lower than for men's clothing shops; 5 per cent lower than for jewelry stores; and about 4 per cent lower than for department stores.

Of course, the cost-to-sell varies with different mail order houses, as it does with different stores. One mail order official stated that it ranged from 16 to 25 per cent.[1] Considering all the lines that it handles and what it would cost to sell them in stores, it is probable that the mail order house has no lower cost-to-sell on the average than the stores. What it saves on rent (1 or 2 per cent) and salaries (about 4 per cent), and on other items, it spends in a larger outlay for items like advertising. It would seem that the advantage of the mail order house lies elsewhere than in its lower cost-to-sell. Most certainly is this the case when the mail order house is compared with the country store where the cost-to-sell is lower than the average.

Advantages of the Local Merchant.—The economic disadvantages of the mail order house might be designated as the advantages of the local merchants. They constitute the grounds on which the country merchant may regain lost trade; they narrow the scope of mail order business; they embrace possibilities for expansion, and may, in the future, be the means of revolutionizing present-day retailing methods. Six of these advantages are considered in the present section.

1. Physical Inspection of Merchandise.—Even though the trend of marketing is toward selling goods by description rather than by the more cumbersome and expensive methods

[1] Wm. C. Thorne, vice-president of Montgomery Ward and Company, before the Parcels Post Sub-committee of the Senate Committee on Post-Offices and Post Roads, January 3, 1912. Superintendent of Documents, Washington, D. C.

of sample and bulk, yet large numbers of people desire to inspect the goods before they purchase them. This advantage, afforded by stores, has not been utilized to the fullest extent because only surface qualities have been exhibited and poor salesmanship has neglected to create the true value of the merchandise in the minds of customers. The clever descriptions of mail order catalogues have enabled the customer to see the merchandise more clearly than when similar merchandise was physically inspected in some store. If stores will physically exhibit goods and at the same time accurately recreate their value by means of attractive descriptions, mail order houses will be at a distinct disadvantage in comparing values favorable to themselves.

2. **Immediate Delivery.**—The delay in securing what is needed deducts from the utility and value of mail order goods. That the customer always pays for such delays is not generally clearly understood. Stores have an opportunity to "sell" this idea to the public by means of advertising and general publicity. If the average customer sees the ebb and flow of values in the concrete purchases of everyday life, he will probably in some cases change the source of his supply. A price can be judged only by the utilities which it purchases; if the price is low the utilities are usually low, and if the price is high there is a presumption of greater capacities to serve the user. To make the customer see these utilities, is the weapon offered store publicity and salesmanship with which to meet mail order competition.

3. **Personal Service.**—Personal service has a distinct advantage over impersonal service. It caters to the vanity of customers and provides a warm human contact between buyer and seller when rightly applied. The store is able to adapt itself to the whims of customers and thereby to individualize

its service, while the mail order house must necessarily standardize its operations. Personal friendships and understandings which arise between buyer and seller make for agreeable and permanent relationships. The store with an attractive and friendly force of salespeople who are continuously looking out for the interest of the customer, is hard competition for the mail order house with its distant and impersonalized force of correspondents. An increasing number of stores are beginning to realize their inherent advantage and are building up attractive personal service and relationships.

4. **Community Pride.**—The majority of citizens in a small town or city are interested in building up the community. This is true because their entire future rests with the development of their environment. Not only retailers, but doctors, lawyers, teachers, preachers, and others are trying to increase their patronage. To show, as can often be done, that no advantage accrues to the individual by purchasing from mail order houses and that community development is handicapped, tends to arouse community patriotism which in some cases has gone far to reduce the amount of merchandise purchased from out of town. As our communities grow older and their sense of citizenship becomes more spiritually solidified, a common understanding may develop which may resent any outside trade intrusion that does not economically better the customer and that saps the vitality of local business interests.

5. **Retail Store's Use of Mail Orders.**—Because the farmer has become accustomed to purchase by description through mail order catalogues, some merchants in the Middle West have endeavored to adapt themselves to this situation and to modify it to their own advantage. Mail order catalogues are now being sent out regularly to farmers even by many of the smaller merchants, and when the descriptions have been

interesting and accurate and the illustrations attractive, the local merchant's claims have been looked into before orders have been sent out of town. The construction of such a catalogue has led merchants to analyze their goods carefully in comparison with mail order articles, and they have been surprised to find that, quality for quality, they could offer equal value for the money.

These mail order departments established recently by some retail stores, have the advantage over the distant mail order houses because they permit of prompt ordering over the telephone and prompt delivery by means of truck or parcels post. Long delays, the writing of letters, or the making out of orders (a difficult task for many people) are eliminated; and at the same time the customer is made to feel that he is part of the community and not outside of it. There is little doubt that the retail store's use of the mail order is only in its infancy, and that this method of making business connections with the farmer will prove to be increasingly productive.

6. **Rapid Development of Transportation.**—The local merchant has secured a distinct advantage over the mail order house in the last decade due to the extraordinary development of local means of transportation. The institution of the parcels post gave a distinct impetus to mail order business, but this advantage has been more than offset by the introduction of the automobile and the laying of good roads. The isolation of country districts, a fertile field for the mail order catalogue, has practically disappeared or is rapidly disappearing with the advent of state and national road-building programs. As regards communication and transportation, forty miles are now, in a great many districts, no more than five miles formerly were; and with increased prosperity, leisure has prompted the farmer to make more frequent trips to town with cash, instead of a charge book, in his pocket.

This revolution in means of communication is likewise setting in motion a readjustment among centers of population which is having an important bearing on the survival of the fittest among retailers. Formerly, the country merchant had to meet stiff competition from mail order houses, but he was quite free from neighboring town competition because of the bad condition of the roads and lack of rapid transportation facilities. Now he is subject to the competition of the neighboring town retailer as well as to that of the mail order house. Battered from near and far, he is rapidly succumbing to the more efficient merchants in the larger towns and cities, who are not only increasing their business because of improved facilities of transportation, but are also capturing mail order business in their own trade territory. Concentration of population is thus increasing the mortality of retailers incapable of adapting themselves to the new situation, and is building up larger and more complex types of retailers in our small county seats and large cities. These larger retail units seem better able to present those services, conveniences, and attractions which go far to offset the lure of the mail order catalogue, and to maintain and keep up to date more complete stocks of merchandise. With the possible advent of the aeroplane as a practical and cheap means of transportation, it is easy for the imagination to call up further readjustments of population in the future, which will carry with them to a hitherto undreamed of extent a corresponding transformation of the retail middleman.

"Taking Money out of Town" Argument.—The stock argument of those interested in the retail business, against purchasing goods from mail order houses, is that it takes money out of town. Economists have answered this from two standpoints: First, the supply of money itself, the circulating medium, is not depleted by such purchases, since money is

not shipped out; the purchases are made by means of credit instruments which are satisfied ultimately by the offsetting of debts between districts. Second, a community from which mail order business is sent is no worse off because of this business but rather better off, since it is presumed that for each dollar sent out an equivalent in value is received which in any case would be more than could be secured for the same dollar from the stores of the community.

While the first answer to the argument is undoubtedly true, the second will stand some inspection. If the customer always secured more for his dollar by purchasing from mail order houses, the community would undoubtedly be more wealthy because of such action. But, on the other hand, if he secures no more for his dollar, local trade languishes and the town becomes of less importance as a trading center and ultimately as a place of residence. Whether or not the customer secures more or less for his dollar from mail order houses is a matter of expert opinion brought to bear on an individual case, and not of "common belief" to be universally applied. Customers do not know merchandise; this is one of the first facts that strikes the merchandising student. Leathers, fabrics, tools, instruments, furniture, and scores of articles are so complex in style and construction that only those who have made a careful study of each line are in a position to give an intelligent opinion.

Recently, an expert in merchandise said that for every article in the mail order catalogue which was cheaper than a similar article sold in stores, he could show an article in the mail order catalogue which was dearer than a similar article sold in stores. Perhaps there is a good deal of truth in the assertion that the total values for similar articles in stores and mail order houses are the same, but that manipulations of price apparently make one middleman's offers more attractive than the others. If this were the case, there would be

only an apparent advantage accruing to the customer who traded exclusively with mail order houses. On the other hand, it is likewise true that a customer might gain by skilfully purchasing those values which were greater for each dollar expended as compared to the values in the retail store. Whether or not there is an advantage or disadvantage in the case of any particular purchase of other than staple goods, must remain a matter for expert decision. But in forming a decision it must be remembered that convenience, permanent supply, favorable means and time of payment, and personal satisfaction must be considered as part of the utilities of the merchandise. When all factors are considered, an extremely complex situation presents itself which places in a precarious position any snap judgments which may be formed.

CHAPTER IX

RETAILER'S MARKET ANALYSIS

Analysis in a Buyer's Market.—Retail marketing costs constitute the largest percentage of the "price spread" existing between the manufacturer and consumer. One of the many reasons for this condition is the lack of an analysis of the quantity and quality of merchandise which any market is capable of absorbing. For the most part, retail purchasing has developed along narrow lines. During the past century, the dominance of a seller's market made unnecessary a close scrutiny of market peculiarities, or even an ascertainment of the degree of market saturation relative to any particular line of goods. The advantage was with the seller of merchandise, and the customer took what he could get. At the present time, however, with a more sluggish but more discriminating demand, retailers are being forced to investigate their market possibilities in order to insure a ready absorption of the growing abundance of a product. Where such market analyses are not being made by retailers, they are by wholesalers, and in some cases by manufacturers. For whoever makes the analysis, the important object is a determination of the consuming power of the population as to quality and quantity of goods.

Inefficient Retail Purchasing Methods.—The methods employed by many retailers in purchasing their stocks of merchandise, indicate their failure to realize the tremendous reversal in market emphasis which has developed within recent years. Custom still dictates the character of much retail

purchasing, although the increasing pressure of goods is making itself felt in some districts. In the prevalent retailing system, however, there are five outstanding defects each of which will be given separate consideration, and in the following order, in the present chapter.

1. Long-time credits, discounts, bargains, or special prices on large orders influence the valuation of goods offered by the jobber or the manufacturer.
2. The purchase of certain lines of goods has been based on friendship for the traveling salesman.
3. "Standard" goods carry no advantage in some markets, yet retailers often purchase them because they consider them "standard."
4. For some merchants, the purchasing of certain lines of goods is based on habit.
5. Some merchants purchase from certain jobbing houses because of a feeling of obligation toward them.

Unless the defects are rapidly eliminated by scientific market analysis the tendency toward integration will become more pronounced, and, as a result, independent retail units will become of less importance in the marketing system.

1. Purchasing Based on Special Inducements.—The first defect to be considered in present retail purchasing methods is the selection of goods because of special inducements such as long-time credits, quantity and extra discounts, and bargains, offered by the jobber or manufacturer. Each of these chief inducements to divert the retailer's attention from a scientific appraisal of his market, and the effect on retailer, jobber, manufacturer, and public of the overstocking which results when such inducements are allowed to exert undue influence, are taken up in detail in the sections immediately following.

Long-Time Credits.—The number of merchants who are attracted by the idea that they can buy now and pay for the goods in one, two, or even three months,[1] and, in the meantime sell the goods, is surprising. If the trade is going to come into a store and demand that line of goods, the results of such a policy are satisfactory; but if the public does not desire this particular line, or changes its mind about it, then the goods are on the merchant's hands and will have to be sold at a loss.

There are several unknown quantities in the equation of buying, and the nature of the demand is one of these. When goods are purchased on long-time credit, the retailer rarely attempts to determine the unknown factor. He assumes that the goods will be purchased by the public within a certain time, but does not command evidence to substantiate this assumption. Forced sales and loss result. What this loss would amount to for all merchants throughout the country, one could only hazard a guess, but that it would be tremendous no one will deny.

Quantity Discounts.—Offers to the merchant of special prices on large orders have been productive of short-sightedness in buying, and account, in many instances, for large stocks of goods that fail to move from the shelves. Only one who has seen the tremendous overstocking of goods among the merchants in the smaller towns can understand what a dead weight rests on the backs of the majority of retailers, and yet they almost invariably believe that they are saving money by buying large orders. Only rarely has one of these merchants been heard to admit that he was overstocked, and even then, nothing more than a guess could be made as to what lines were in excess. This lack of knowledge of the existence

[1] Ninety days' credit is almost obsolete now.

of overstocking makes education along this line especially useful, and, where it has been given, flatteringly productive.

Turnover versus Quantity Discounts.—That the merchant in most cases[2] loses money by this method of purchasing can be shown by an illustration. Suppose a merchant every month buys a dozen of an article that costs him 75 cents per dozen, and sells a dozen every month at the price of $1. At the end of the year, this merchant has turned this 75 cents twelve times, making 25 cents every time, or, in other words, has made $3 on an investment of 75 cents. Then a specialty salesman comes along, and says: "You are paying too much money for those goods. I can sell you that same article for $6 a gross." It looks like a saving, so the merchant takes a gross. During the year following this purchase he sells a dozen a month, or the entire gross, at a profit of $6. In other words, he has made $6 on a $6 investment, or 100 per cent, while under the former method of buying he made $3 on a 75-cent investment, or 400 per cent.

When it is acknowledged that this hypothetical case represents actual conditions and could be multiplied by many lines in any one store, it will be realized what a tremendous saving could be effected by a different method of buying. Instead of permitting the $6 to carry one line, it should be more fully utilized and made to carry twelve 75-cent lines. The jobber would be forced to function as a warehouse instead of the store, making not only for better appearance of the latter, but for larger retail profits.

Overstocking—Failure.—Thus it must be evident that all parties concerned, the jobber merchant, and the public, would

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[2] During a period of rising prices this method of buying can often be justified to a limited extent, but if carried very far becomes speculation pure and simple. The buyer then tries to liquidate before a falling market brings him loss, not merely in sales, but in inventory.

benefit by a more rapid turnover of stock. The jobber cannot hope to build up a permanent trade by stocking merchants with goods that will not move. He may make immediate gains, but this policy continued will force his customers to the wall and make necessary the formation of trade connections with new dealers. Unfortunately, jobbers are only too often short-sighted and persistently continue to "load" merchants until the latter are forced into liquidation. Often the direct cause for such failures is not ascertained by financial investigators, and classifications such as "lack of funds," "incompetence," or others equally inaccurate are used to indicate the reasons for insolvency, when, in reality, these are only conditions of failure—not causes. On the surface, "lack of funds" often appears as the fundamental reason for going out of business. This condition, however, is caused by wrong buying methods; most merchants have sufficient capital to carry the necessary number of lines and meet contingencies, but instead of conserving it, they let much of it lie idle.

Overstocking—Inefficiency.—But even if it is to the advantage of jobbers to overstock retailers, or if they continue this policy against their own interests, because of the ignorance of their salesmen or for other reasons, it is plainly to the interests of the merchant to thwart such attempts whenever possible. When overstocked the merchant is handicapped by lack of capital; his profits are lower; the number of clearance sales with all their attendant disruption of routine are increased; the appearance of his store is less suitable for attracting trade; the congestion of stock often interrupts the speedy finding of goods; and most important of all, his salespeople forego the stimulating effect of the frequent arrival of goods.

The Public's Interest.—The public is too interested a party to permit such a condition of affairs to continue. Buying

in this manner means fewer goods than might otherwise be offered to customers, poorer service, loss of time, and higher prices. The latter is true because the interest charges on the stock are greater, and in many cases a lack of funds caused by this inefficient use of capital prevents taking up discounts the use of which would have permitted a lower selling price. A growing realization on the part of the buying public of the disadvantages of such methods of buying gives promise of better conditions. But greater progress can be made if retailers will quickly realize their responsibility as public servants.

The Manufacturer's Interest.—The manufacturer also is vitally interested in the purchasing methods of retailers. Slow-moving stocks mean less ready capital with which to pay bills promptly and purchase new stock. With unattractive goods customers are not exploited, and only partial saturation of the trade territory results. This slowing up of the stream of goods is causing manufacturers to make investigations of the consuming power of communities, so that the retailers may be stimulated to study their opportunities and make more intelligent purchases. The retailers must speed up their selling or meet the competition of speeded up retail stores owned by manufacturers.

Extra Discounts.—To offer extra discounts and so induce merchants to buy a particular line is a common practice, and where the goods are of the right kind it can be justified. Too often, however, the merchandise is of such a nature that it can be disposed of only by extraordinary means, in which case it is safe to assume that the merchant gains nothing from the extra discount. Such goods usually cost the retailer more in the end than those on which a lower rate of discount was offered. While retailers realize that customers pay for

premiums offered with certain articles, they often fail to see that extra inducements in the nature of extra discounts are, in reality, premiums that are held before the eye in order to obscure some uncertain qualities in the goods themselves. When this and other unscientific methods of purchasing are followed, the retailer fails to look objectively at the trade territory or market, contenting himself with superficialities and overlooking the real *raison d'être* for the goods on the shelves.

Bargains as Inducements.—The chief inducement used to divert the retailer's attention from a scientific appraisal of his market, is bargaining. Perhaps some jobbing house has gone to the wall, or has had a fire, or, for some other reason, has a stock of goods that it wants to be rid of. An alluring price is placed on the job lot and a clever salesman unloads it on some retailer who does not think clearly. It is no doubt true that some real bargains are secured in such cases, but more often the retailer is ensnared in the same mesh that he uses to attract customers to his own bargain sales.

Human nature seems to be the same, whether found in retailer or in customer; a bargain appeals strongly to each, and for the time that it is held before the eyes it seems disproportionately attractive. Of course salesmen understand the necessity of laying all the emphasis on the strongest buying motives, hence this activity is not profound in its complexity. The marvelous feature of such transactions is that the uppermost buying motive of retailers should be what it is. The prominence of the motive to "get something for nothing" must give way to others whose existence will further more precise and accurate purchasing, if retailers are to furnish a satisfactory outlet for large-scale production.

2. **Purchasing Based on Friendship.**—Friendship for the traveling salesman has been found to be the chief reason for

some retailers' purchasing certain lines of goods, although the latter were unconscious that this was true and were reluctant to admit it when apprised of the facts. When the line sold to retailers by means of friendship has coincided with the results secured from an investigation of the market as to what should be sold (quantity and quality considered), no harm has resulted; but obviously such a coincidence could exist only by accident. Friendship has usually resulted in blinding the merchant to existing conditions, for a knowledge of which have been substituted highly colored and strictly hypothetical conditions prepared and held in view by the salesman. As in the case of bargains, sales are made because of attack through a vulnerable point.

The quality of friendship is with some merchants, as with men in other occupations, a prominent characteristic, overshadowing and subordinating all others and making the possessor one-sided and incapable of unbiased judgment. To such, friendliness on the part of the salesman is of undue magnitude, and all other considerations sink into the background. Lines better qualified to meet local conditions receive no consideration, partly because of lack of friendliness on the part of the salesman representing them, but more because of loyalty to the friendly salesman representing the other lines.

It does not necessarily follow that the salesmen who ingratiate themselves with this type of merchant are entirely conscious of their own activities. Perhaps they are the "born" salesmen type who make up in friendliness what they lack in the knowledge of their goods. Whatever the source of their influence, it remains true that such friendship between merchant and salesmen is exceedingly costly to the former, as well as destructive of self-discipline to the latter. And when this friendliness stimulates a merchant to leave one jobber and go to another because a certain salesman has left the former for the latter, several cases of which have been found,

it assumes proportions that become a menace not only to the retailer but to the public as well.

3. Confining Purchases to "Standard" Goods.—Retailers often purchase goods because they are nationally advertised and considered "standard." Nationally advertised goods carry no advantage in some markets, and when the practice of confining purchases to this class of goods is followed, many important factors in the buying equation are overlooked. What is considered standard by some classes of people is not always recognized as standard by others. The supposition that all classes of people view merchandise from a certain standpoint has, as its premise, the fallacy that all persons are educated equally regarding it. Many cases are known where retailers have purchased lines advertised in standard magazines rather than to put on their shelves the goods of an obscure manufacturer, even though the latter carried with them a larger percentage of profit. Some nationally advertised goods seem to have won their place in the store simply because of their ubiquity in the magazines read by the retailer. The very persistence of these advertisements has misled the merchant, for he has assumed that those in his trading territory or market have been equally educated and impressed. Only too often this has not been the case.

Social and Economic Surveys.—From an investigation[3] of the social and economic conditions in a typical township in Iowa, it was found that only one family in fifteen was a subscriber to a standard magazine, only one in every ten took a religious paper, and only one in every three subscribed to some daily newspaper. From this it would seem that many merchants are not getting what they are paying for. In other

[3] L. B. Mounts, A Survey of the Social and Economic Conditions in a Rural Township, p. 64, Iowa City, State University of Iowa, 1917.

words, they are accepting a lower percentage of profit per article because they expect a larger volume of sales due to national advertising; when, in reality, the sales of the nationally advertised article may not be much larger, if any, than those of obscure brands, simply because the magazines in which they appear do not have a wide circulation in their market. Not having carried some obscure brand, the retailer naturally cannot know whether the advertised brand is the means of producing more sales.

It would seem that the dictates of self-interest would impress upon any merchant the necessity of acquainting himself with the extent of the national advertising in his market. A survey should be made to ascertain what per cent of the potential buying public are subscribers to the magazines in which the goods are advertised. With this information, any merchant could quickly decide whether to buy nationally advertised goods carrying a small per cent of profit, or private brands carrying a more generous margin.

Co-operative Market Analyses.—A magazine survey might be made by any individual merchant, but since the character of the magazine subscriptions in the community is a matter of interest to all merchants, it would seem that such a survey could best be planned and carried out through the organized facilities of a commercial club or community organization. Moreover, just as it is more difficult and expensive for any one individual security-holder to ascertain the true character of the property represented by his certificates than for an organization of brokers, bankers, or stockholders to obtain such knowledge, so it is more difficult and expensive for any individual merchant to attempt to find out the nature of the magazine subscriptions in the market than for an organization to collect and disseminate the data. Such a survey will repay any ordinary expense connected with securing it.

Ignorance of Market Reduces Profits.—In many cases merchants will find that they have been sacrificing profits for years by carrying certain lines, around which the salesmen or themselves have created a halo of public recognition. To ascertain what the public is willing to buy rather than to assume its attachment to certain lines because of national publicity, is a change in point of view that should mean more profit to retailers and the purchase of goods that are more acceptable to the consumer. Assume nothing, ascertain everything, is a safe policy for merchants to follow in purchasing. The market must assume greater significance than store convenience or retailer opinion.

4. **Purchasing Based on Habit.**—With some merchants the purchasing of certain lines of goods is nothing more or less than a habit. Some temperaments get into well-defined mental grooves more readily than others, and it is apparently as hard to get out of them as it is to break a physical habit. A habit shortens the time necessary for the performance of an act, and it is probably because of this fact that it is usually allowed to direct the purchasing of goods. Habitual tasks can be accomplished in a surprisingly short space of time but tasks that demand specific attention require a longer period for accomplishment. To make buying automatic and avoid the irksomeness incidental to continued application, seems to be the aim of some retailers. In other words, some merchants are mentally lazy and seem to become exhausted if their attention is concentrated on any problem for any length of time. Like any other laziness, this kind can be dissipated by work. Close attention to marketing problems is the only means of creating vigorous thought regarding them.

Inefficiency of Automatic Purchasing.—Needless to say, purchasing cannot be made automatic; it cannot be performed

in a habitual way. Ideas are changing too rapidly to permit stability and uniformity of quantity, quality, and style in goods. It is only in more or less routine work that habit can play any great part. Some merchants, no doubt, wish that styles and other characteristics of goods were more stable, but their hopes are no determining element in actual conditions. Only too often men of this type substitute the imaginary for the real; and then it is that habit becomes a vicious factor in business. This situation reminds the writer of a building contractor who refused to put fireplaces in his houses because he said the public was foolish to demand them. The fact remained that the public did demand fireplaces, and was willing to pay for them; and it got them, regardless of what the contractor thought.

Knowledge of Demand.—Buying is the chief problem of merchandising. The old saying, "Goods well bought are half sold," contains much truth. To buy goods of the right quantity, style, and quality, is perhaps one of the most intricate and difficult of arts and can never be reduced to routine. Neither can it be turned over to inexperienced employees, while the proprietor uncrates goods at the rear of the store. If the merchant has real merchandising ability, a large part of it will be expended in scientifically purchasing goods. Accounting matters, store arrangement, window decoration, and other important duties can be standardized and turned over to others to supervise or perform much more easily than can the function of buying. It is true that others can gather data on which the buying judgment may be based, but the important fact remains that the judgment itself must be made by the person with the greatest merchandising ability and experience, and in the smaller establishments he is usually the proprietor. The most difficult and exacting work should be done the most thoroughly and by those best qualified to perform it.

5. **Purchasing Based on Sense of Obligation.**—Some merchants purchase from certain jobbing houses because of a feeling of obligation towards them. A sense of obligation may have developed because a jobbing house stood by the merchant, or gave valuable concessions when he badly needed them, or provided some other service of importance. That the merchant owes a debt to the jobber who has extended him credit at a critical time in his existence, or who has given him any other valuable service, goes without saying. Yet this debt can be repaid at a ruinous rate. For a merchant to buy goods of a jobber because the latter has befriended him, is usually to pay a high price for that service. It would be far better for the retailer and the public if the former paid for this service at a money price considered fair by all parties connected with the transaction, than for him to feel obligated to purchase in ignorance of the demands of his market.

Anything that tends to divert the attention of the merchant from the real reason for buying, i.e., the nature of the demand, is a dangerous obstacle to successful merchandising, especially if the object of distraction is itself attractive. The enticing behavior of siren jobbing houses should not blind the retailer to the ultimate disaster that lurks near-by. The extra services that some jobbers perform are real, and of money value, but the retailer must be wary of all such attractions; he must chain himself to the steering-wheel of duty and run his business craft where his chart and compass indicate—and that is in the direction of the rapidly fluctuating and highly sensitive demand.

Basis of Efficient Method.—In the preceding sections, dealing with inefficient methods of purchasing, it has been pointed out that the purchasing of a great many retailers is defective because certain matters receive undue consideration and pre-

clude an interpretation of market tendencies and possibilities. Conversely, the basis of efficient purchasing lies in ascertaining, judging, and accumulating facts regarding the demand for goods, and formulating from these facts generalizations or principles that will serve as accurate guides in purchasing merchandise. These processes must be in continual operation, as the conditions with which they are related are in constant movement and subject to change. The buying equation includes many variables which cannot in all cases be determined accurately, but their value and significance must be estimated on the basis of known facts, which, in their turn, have been carefully gathered and evaluated. The goods finally purchased will thus represent many interrelating and highly changing factors; just as the course of any steamship is the result of many conditions, such as the velocity of the wind and the current, the humidity, and the temperature, as well as the internal conditions of the ship itself.

Even those dealers who make an effort only to estimate marketing factors, realize that the more factors they take into consideration, the less inaccurate will be their decisions as to purchasing. The difficulty is that too many retailers feel that they are equipped to estimate the conditions affecting the demand, and that analysis is unnecessary in determining their significance. What many believe to be an estimate is, in reality, only a guess; and it is little wonder that so many business superstructures collapse when their foundations are an unknown quantity. Demand is the foundation of all retail business, and its nature and extent must be known—not guessed at. Human nature is a highly changing factor in the buying equation, and consequently the greatest discrimination in gathering data, and the most unbiased judgments in weighing facts, should be used. It is with all these difficulties of the situation in mind, that the "trade survey" as a method of market analysis is presented.

The Trade Survey.—The purpose of the trade survey is to ascertain in terms of money value, a community's consuming power. This information is secured in the following manner: From the production figures at mill-cost price for any commodity in the United States, as found in the United States Census, are subtracted all exports of the same commodity, and to the difference are added all imports. The mill-cost consumption figure for this commodity thus obtained is then multiplied by the average retail mark-up, [4] and the product represents the gross sales of this commodity in the United States.

The per capita consumption of this commodity can then be found by dividing its gross sales figure by the population of the United States. The per family consumption can be found by dividing the gross sales of the commodity by one-fifth of the population, while the consumption of the commodity for every man sixteen years of age and over, can be determined by dividing the gross sales of the commodity by 35 per cent of the population.

Defining the Market Limits.—From these consumption figures for all lines of commodities, the consuming power of any community can be ascertained in terms of money value, provided the boundaries of the community can be defined. For example, if it was found that each family in the United States makes an average expenditure on groceries of $228, in order to get for any community the total consumption figures for groceries, it would still be necessary to determine how many families could be considered as economically included within that community. At first thought it might seem that this determination of a community's trading popu-

[4] The retail mark-up can be ascertained for several communities, and averages struck. Information of this character, sufficient for purposes of a trade survey, has already been collected.

lation (often known as its trade territory or market) is a purely arbitrary matter. This is far from being the case, although some writers have indicated that, on the average, every city should draw from an outside territory that embraces a population equal to 40 per cent of itself.

It is obvious that many conditions determine the extent of any city's trade territory. Geographical conditions are often very important in freeing a city from outside competition, or in handicapping it in the race for trade. Extraordinarily fair and comprehensive merchandising methods have been the means of some cities' including in their trade territory outlying districts whose population was equal to 75 per cent of that of the city. All of which indicates that each city must be considered as an individual case from the standpoint of a market.

Differentiating Overlapping Markets.—The trade territory of a city must be taken to include the population of the city and all outlying districts that are directly and naturally tributary to it. This includes outlying territory that for any reason whatever does and should trade in the nearest city. In most cases the population of these country districts will not be exactly 40 per cent of the population of the city that forms their trading center. If villages having retail stores are included in the city's market, usually some fraction (not easily determinable) must be deducted from the trade territory in order to get a fair estimate of the city's trade possibilities. The retail facilities of both city and villages will have to be taken into consideration in determining where the trade boundaries of one community end and the other begin. Of necessity communities overlap, but nevertheless they usually have boundaries that are more or less natural in character and that serve to differentiate aggregations of people with common interests.

Market for Different Commodities.—While what constitutes a city's market can be determined in the manner indicated, it is nevertheless true that the extent of that market varies with different lines of goods. For example, it has been found[5] that a city's trade territory is much larger for ladies' ready-to-wear apparel, dress goods, jewelry, books, furniture, pianos, dry-goods and for men's suits, than it is for implements, lumber, groceries, drug store sundries, and phonographs. Because of this fact, it would often be misleading to assume that a certain district should comprise a city's market for groceries because it is the city's market for ladies' ready-to-wear clothing. Accuracy in determining any city's market can come only through considering its local peculiarities.

Qualitative Market Analyses.—Not only a quantitative market analysis should be made, but likewise a qualitative. Knowing the number of stoves a community should require, does not indicate the kind of stoves it is using or the changing trend of demand. This knowledge can be secured only by constant contact with the consuming public and personal investigations of what is in use. In a hardware store in a town of 900 inhabitants an investigator discovered nothing but cheap stoves. On being asked why he did not carry some high-grade ranges, the retailer replied, "They want cheap stuff in this town." The investigator went to the telephone, called up sixteen housewives, and asked them each one question, "What kind of a stove have you in your kitchen?" Twelve out of the sixteen had a certain well-known standard brand of range. They purchased them out of town. In some towns the investigator found that women were purchasing their shoes out of town, because the styles sold in the town's

[5] Where Farmers Trade, p. 8. Topeka, Kan., The Capper Publications, 1917.

stores were not to their liking. Watching the feet of people as they walked past the stores would have been a most enlightening market analysis for the shoe dealers of that town. Sometimes a house to house questionnaire or canvass has indicated what customers wanted and what they were using. These and other plans of qualitative market analysis mean goods more to the customer's liking, fewer carry-overs, a lower marketing cost, and a more satisfactory outlet for the manufacturer's product.

CHAPTER X

MANUFACTURER MARKET ANALYSIS

Development of Manufacturer Market Analysis.—During the seller's market of the last century, manufacturers were concerned primarily with creating goods and getting them to the market. Now, during a buyer's market, manufacturers are chiefly interested in ascertaining the absorption capacity of the market. With this information, the production phase of the business can be controlled, and the distribution or sales department is enabled to act intelligently in its locality emphasis. Even though the orthodox method of distribution is followed, it is desirable for the manufacturer to have first-hand knowledge of his markets. This knowledge comprises information as to the following points in particular:

1. Where the goods are sold.
2. What classes of people purchase them.
3. The chief reasons why they are purchased.
4. The characteristics of the men who are selling the goods.
5. The conditions under which the dealers are working.
6. The nature of the dealers' sales methods.
7. The costs of sales.
8. Alternative methods of selling and their relative advantages for particular territories.

Methods of Gathering Market Data.—Market knowledge is now being secured by research departments, which are being created in increasing numbers by manufacturing concerns, groups of department stores, and wholesalers. Expert

analysts, statisticians, and investigators make up the staffs of these departments. Their work consists of analyzing the field, or market, organizing the resulting data in clear and concise form, and formulating conclusions based on these data. Previous to the creation of research departments many manufacturers made a practice of gathering market data, but the methods pursued were for the most part haphazard and desultory. Much important market information was never analyzed because it was never worked up in a form to be readily comprehended by those who could profit by it. Graphic methods of representation, by means of which the presentation of facts to managers and boards of directors has become a comparatively simple and interesting operation, have advanced market analysis considerably. These and other methods of the analyst and statistician have provided the necessary tools by means of which market facts may be utilized to determine production and sales policies. Knowledge of the market is thus truly becoming a directive force in commerce, and the modern research department forms the medium through which it is enabled to operate.

The Manufacturer's Market.—The market of the manufacturer may consist of one, two, or three parts. If the orthodox system of marketing is used, there is first, the immediate market—the wholesaler; second, the intermediate market—the retailer; and lastly, the ultimate market—the consumer. If the wholesaler is eliminated, the intermediate market becomes the immediate market; and if the manufacturer sells direct to the consumer, the latter becomes the immediate as well as the ultimate market. In a buyer's market a careful analysis of each of these classes of customers is a growing necessity. Knowledge must be had of the sales methods pursued by each market functionary as well as the buying habits of customers and the influences which affect them, since

it is only from this information that the manufacturer can determine reasons for increasing or slackening up his distribution.

To understand fully the strength and weakness of each market functionary is to be in a position to make prompt readjustments in the direction either of further differentiation or integration of market functions. Ignorance of any of his markets places the manufacturer in a dependent position as regards his distributors. Market analysis means for him independence and lower costs in the distribution of goods, because more rapid readjustments in marketing machinery can be made.

Analysis of the Wholesale Market.—It is possible that a thorough analysis of the wholesale market for each product would alter materially present channels of distribution. Some merchandise which is now being sold direct to the retailer would probably employ the wholesaler as a medium, while some merchandise being distributed through wholesalers would no doubt move direct to the retail market. An analysis of the different markets would reveal their relative advantages for goods of different types, and presumably adjust the market machinery to the goods which it must handle. The more complete the analysis, the more the questions to be answered. Methods long taken for granted would have to justify their continued existence by the efficiency with which they could operate under changing conditions. The existence of a buyer's market is hastening such an analysis, but in many lines of goods its pressure has not yet been felt sufficiently to induce manufacturers to scrutinize the character of their immediate market. The manufacturer who makes this analysis before he is forced to do so by the changing market emphasis, is the manufacturer who will lead his competitors in the race for trade under the new conditions.

A Cross-Section of the Wholesale Market.—An analysis of the wholesale market would result in securing a market cross-section which would answer for the manufacturer the following important questions:

1. How long has the wholesaler constituted our immediate market?
2. Why was he originally chosen as our immediate market?
3. Are the conditions which dictated the original adoption of this market now operating?
4. Is this market functionary satisfied with our treatment of him?
5. Is the wholesaler "sold" on the superior value of our goods as compared with similar goods?
6. Is the wholesaler's percentage of profit on our goods as great as on competing goods which he does not handle?
7. Is his percentage of profit on our goods as great as on other goods he handles?
8. Is his total profit from the sale of our goods larger than the total profit from the sale of other similar goods?
9. To what class of retailers does he sell our merchandise—good risks, bad risks; quality dealers, price dealers; retailers catering to special classes, etc?
10. What characteristics of quality, style, service, etc., pertaining to our goods, does he emphasize in selling to the retailer?
11. What competing lines does he carry?
12. As regards turnover, what position among competing lines would our product take?
13. Is our merchandise given preference over others? If it is, what reasons account for that preference? If not, what merchandise is thus favored and why?
14. Does the wholesaler appreciate our efforts to create dealer- and consumer-demand?
15. Has he any idea as to how the mediums of demand-creation could be improved in effectiveness?
16. To what extent is our advertising material utilized in selling our product?

17. To what extent is the advertising material of competitors utilized in selling their product?

18. Do competitors co-operate with the wholesaler to a greater extent in selling their goods?

19. Is the demand for our goods increasing or decreasing? Why?

20. Is the demand for our goods increasing or decreasing as rapidly as competitors' goods? Why?

21. Has the wholesaler handled our goods continuously, or has he handled them intermittently?

22. Why has the wholesaler ceased handling our goods?

23. Do his private brands compete with ours?

24. Is he interested in manufacturing his own brands?

25. Is he interested in securing his own retail outlet?

26. Does he sell direct to large institutions?

27. Has he antagonized retailers by his methods of sale?

The consideration of such questions enables the manufacturer to visualize the extent and character of the market for his merchandise. It cannot but promote more intelligent marketing, i.e., marketing through the most efficient channels.

Analysis of the Retail Market.—Whether the retail market is for him the immediate field or an intermediate one, the manufacturer does well to know its character. At the most inopportune moment economic conditions may change it from an intermediate to an immediate market, leaving the manufacturer unable to cope successfully with new responsibilities. Besides, the efficiency of the immediate market cannot be fully visualized without a comprehension of its outlet. All markets are interrelated; they cannot be satisfactorily understood when isolated and studied by themselves. Whether the wholesaler is living up to his opportunities cannot be determined without knowing the nature of his opportunities. To know the relationship between markets is to be independent of the cramping influences which often dominate the methods pursued by market functionaries. Furthermore, integration of

market functions is more easily accomplished when the interrelating markets are thoroughly understood by manufacturers. Chain stores, mail order houses, and manufacturers' agencies would never have arisen had not a diagnosis of the retail market indicated the probability of their success. More widespread and thorough analyses of the retail market may reveal further possibilities for market modification. The most delicate adjustment of marketing machinery to market functions can never be made unless market conditions and relationships are completely understood. A market analysis produces this comprehension.

A Cross-Section of the Retail Market.—On the whole, the analysis applied to the wholesale market applies also to the retail market. In addition, such knowledge of the market as is represented by answers to the following questions seems necessary:

1. What is the nature of the retailer's location?
2. Does he have modern show-windows? Are they attractive? How often does he change them?
3. Has he modern fixtures? Are they arranged to care for the trade advantageously?
4. Is the store modern in other respects, such as lighting, heating etc.?
5. Is the stock attractively displayed? Is it marked in plain figures or characters?
6. How much stock does he carry?
7. What is its turnover?
8. How much of our own stock does he carry?
9. What is its turnover?
10. How often does he take inventory? Has he a perpetual value or quantity inventory system in any department?
11. How often has he special sales for closing out stock?
12. Does he maintain manufacturers' prices, or is he a price-cutter?

13. Is he interested in working out schemes for increasing his business?

14. What percentage of profit does he consider necessary?

15. What is his cost of doing business? Is it correct?

16. What percentage of his business does he secure by mail order, telephone, solicitation?

17. Has he a delivery system? Is it adequate?

18. How many salespeople does he employ? On what basis does he pay them?

19. Do his salespeople have any opportunity for salesmanship instruction?

20. What is the nature of his competition—local, near-by cities, mail order?

21. What methods does he employ to meet competition?

22. Does he prefer to mail his orders for goods, or does he prefer to give them to our salesmen?

23. How often do salesmen representing a similar line call? How often do they show their samples?

24. How often does our salesman call? How often does he show his samples?

25. Does our salesman build up confidence for our house?

The Retailer's Attitude Toward Advertised Goods.—Besides the data secured from answers to the above questions, it has been found desirable for the advertising manufacturer to ascertain the retailer's attitude toward advertising and advertised goods. Answers to the following questions give the desired information:

1. Does the retailer subscribe to trade papers? What are they?

2. Does he read the advertisements in them? Does he stimulate his salespeople to read them?

3. Does he subscribe to general magazines? What are they?

4. Does he read the advertisements in them?

5. Are such advertisements productive of orders?

6. Does the retailer believe in advertising? What mediums does he use? Which are the most productive?

7. Is dealer-literature made use of? What is done with it?

8. Are trade-marked goods given preference?

9. Does the retailer co-operate with national advertising campaigns?

10. Does he have a store slogan? Does it represent a distinctive store feature or service?

11. Has he any conception of the marketing function of advertising and its relation to distribution costs?

With such information before him the sales manager becomes a well-informed general who knows the topography of the battlefield and the strength of the forces with which he has to contend. If success crowns his efforts, he can put his finger on the circumstances causing this result; if sales efforts result in failure, the reason therefor is as readily discovered. The retail market analysis does away with guesswork and haphazard results. In a buyer's market, such analysis is indispensable market machinery.

Analysis of the Ultimate Market.—It is for the ultimate market that all merchandise is produced, although some goods become unsalable en route through the other markets. To understand the conditions with which the retailer has to deal is no less desirable than to understand those affecting the distribution of the wholesaler. Notwithstanding the fact that both retailer and wholesaler may be used in marketing the manufacturer's goods to the consumer, these market functionaries are often unaware of market possibilities; it is rare that of their own motion they seek the complete saturation of the market. When, however, market possibilities are brought to their attention these middlemen often assume greater responsibility for intensifying distribution in their territory. In a buyer's market the pressure of potential supply

makes it imperative that market saturation be more completely realized, and this may be accomplished through increasing demand by means of market analyses on the part of manufacturers and middlemen, or by integration. As long as the middlemen recognize the necessity of co-operating with the manufacturer in ascertaining market possibilities, just so long will integrating movements be retarded; but when wholesalers and retailers are tardy in their response to the manufacturer's effort to enlarge his distribution, the forces of integration are accelerated.

A Cross-Section of the Ultimate Market.—An analysis of the ultimate market seeks to determine the extent and character of the demand. Demand must be analyzed from the standpoints of: location, consumers, climate, financial conditions, transportation, and competition. Answers to such questions as the following must be sought:

1. *Location.* Does the demand come from cities, small towns, or rural districts? Is it localized or national in scope?

2. *Consumers.* What percentage of the population is rich? Of medium circumstances? Poor? What percentage is married? Single? Old? Middle-aged? Young? What percentage consists of laborers? Agriculturists? Professional men? Business men? Mechanics? Clerks? Servants? What nationalities predominate? Are the inhabitants of the territory included thrifty? Is the population pleasure-loving or serious-minded? Do customers ask for our product by name or trade-mark? Do consumers subscribe to magazines which advertise our product?

3. *Climate.* What is the characteristic climate for each month of the year? During what seasons is rainfall heaviest? In what respects does the climate affect the buying habits of the population?

4. *Financial conditions.* What important industries are located in the territory covered? Do surrounding crop conditions affect local business? What effect do national indus-

trial influences have on local industries? What is the strength of local financial institutions? Have there been labor troubles in this territory? Are wages high or low? What is the outlook for continuous industrial activity?

5. *Transportation.* What is the nature of transportation facilities—steam roads, electric roads, water routes, trolley lines? Are these facilities adequate? Are they improving or declining in efficiency? What is the length of haul? What are the rates? Are they higher or lower than competing districts? What is the number of rural free delivery routes? Are these routes utilized?

6. *Competition.* Do customers prefer a competitive article? What are the reasons for this preference? What percentage of the per capita consumption is secured by the retailer handling our merchandise? What percentage of the per capita consumption is secured by local retailers handling competing lines? What percentage of the per capita consumption goes to near-by cities or mail order houses? [1] Do competing regions possess any vital advantages over the local district? Will these advantages increase or decrease in importance?

Analysis of Demand and Product.—If the manufacturer intends to advertise his product, an analysis of another phase of market demand is necessary, namely, a study of the reasons why people should purchase the product. These reasons or motives for buying cannot be ascertained without an analysis of the characteristics of the commodity and its ability to satisfy certain requirements.

Merchandise falls into two general classes: [2] (1) that which requires an increased expenditure of the customer's money, and (2) that which merely changes the direction of present expenditures. In the first class are two types of goods: (1) a new product which meets an existing and evident need, and (2) a new product whose lack the customer has

[1] See Chap. IX.

[2] C. D. Murphy, What Makes Men Buy? *System*, Sept., 1912.

never felt and which appears to be merely an extra and unnecessary expense. To sell the latter product throws a heavy burden on the sales organization and can be accomplished only by following methods entirely different from those used in selling the former product. In selling a product which meets an existing need—for example, cigars—it is only necessary to explain, describe, and illustrate the product, indicating that it is just what has been needed for a long time. In selling a product the need for which has never been felt—for example, a set of encyclopedias—the customer must be made to feel the disadvantage of being without it. The sales effort must be vigorous and inspiring enough to induce the customer to make an extra effort to earn or save the money required for the unexpected outlay on an article of uncertain need. Failure properly to analyze the product would probably result in confusion of appeals and loss of distribution.

In the second class, made up of familiar goods, are also two types: (1) familiar goods offered in a distinctive manner, and (2) familiar goods offered in the usual manner. With goods of these two types the problem is to change the customer's habit of buying some other brand. Not merely must the brand be suggested, but "reasons why" must be advanced to produce a motive for changing the buying habit. When the housewife decides to purchase a new brand of chocolate, flour, or canned goods, it is almost invariably because genuine reasons have been advanced which have induced her to do so. An analysis of the goods reveals the motives for buying them, and the appeals in advertising and selling which must be used in order to give them successful distribution.

Another Scheme of Commodity Analysis.—The sales manager of a large corporation[8] has divided the analysis of a

[8] R. E. Fowler, *Printers' Ink*, Feb. 18, 1912.

commodity into six classifications: demand, serviceability, quality, price, profit, competition. The study may be outlined as follows:

1. Demand is developed or undeveloped, forced or natural, permanent or seasonable.

2. Serviceability is determined by answers to the following questions: Is the article a necessity? Is it a luxury? Is it a convenience? Is it durable? Is it economical in use?

3. Quality may apply to raw materials, design, workmanship, appearance, and finish. How does the article in question compare with competing articles in these points?

4. Price applies to the jobber, broker, retailer, and consumer. Is the price high, medium, or low? How does it compare with the prices of competing articles?

5. Profit also applies to the jobber, broker, retailer and consumer. Is it larger, equal to, or smaller than on competing lines?

6. Competition is officered by old men or young men, men who are aggressive or lax. Is the competition recent, or long-established? Is it from concerns that are wealthy, or of limited means? What are their sales plans, their advertising campaigns, their policies toward customers? What characterizes their sales managers, their sales force, their credit department's attitude toward customers?

Commodity Analysis and Market Possibilities.—Just as market analysis determines the possibilities for the sale of commodities, so commodity analysis determines to what extent these possibilities are real so far as any particular article is concerned. As the commodity cannot exist apart from the market, neither can the market be considered as distinct from the commodity. Both are part of the same thing—satisfactions. In analyzing commodities, a search is instituted for qualities which correspond to demand, active or latent. If these qualities are discovered, a demand or market for the goods exists—wealth has been created; if no qualities can

be found which thus correspond to active or latent demand, or if such qualities are present only to a slight degree, no demand or market for the goods exists—no wealth has been created (or a less degree of wealth than was anticipated by the manufacturer).

Thus it is seen that wealth or value does not exist unless it exists in the minds of people; unless, that is to say, there is a demand. Creation of goods, therefore, is not necessarily creation of wealth. The latter is obtained only when a market, or demand, is assured for the goods. A market requires buyers as well as sellers; it requires demand as well as supply. If the supply exists but not the demand, the demand must be created; just as when the demand exists but not the supply, the supply must be created. Satisfactions, utilities, wealth, or value cannot exist excepting as counterparts of each other in the minds of buyers and sellers; that is to say, they cannot exist excepting in a market. When this conception of the market is fully realized, more attention will be given to creating markets by analyzing commodities for points of contact, rather than in the mere making of market surveys which often accept values as they exist at the time and not as they may be created. In a very real sense the market is in the goods themselves. Whether or not this market is discovered, depends on the thoroughness of commodity analysis. It must discover satisfactions which correspond to desires that are in consumers' minds.

Advertising and salesmanship are merely vehicles for connecting up these "counterparts of satisfactions." If they are discovered in both commodity and consumer, and properly connected up, the commodity is sold. If the counterparts of satisfactions are not discovered, they cannot be connected up; or if they are discovered but not properly connected up, the sale is lost. Marketing deals with the discovery of the counterparts of satisfactions, and with the market functionaries

whose business it is to make connections between them. It is not to be forgotten that selling is only one phase of making this connection. Sorting, grading, classifying, risk-taking, transportation, financing, etc., are likewise necessary in connecting the counterparts of satisfactions. It might be said that often the selling function merely appears to be the most important because it appears last in the series. Yet in a very real sense the importance of selling overshadows that of the other functions, because no matter how well they have been performed, they have been performed for naught if the goods are not sold. Hence the present-day stress upon advertising and salesmanship.

Counterparts of Satisfactions in Commodities.—Manufacturers are beginning to recognize as never before the possibility of finding the counterparts of satisfactions in commodities. Laboratories are being created and scientific analysts are being employed in the effort to ascertain existing but invisible satisfactions. Cooking-fats, textiles, safety-razors, hammers,[4] tooth-paste, automobiles, office equipment, and hundreds of other articles are undergoing an analysis which a few years ago would have seemed misplaced. But all this is necessary in a buyer's market. Goods are seeking the market. They must be able to show counterparts of satisfactions before they are marketable.

If the article itself has no more counterparts of satisfaction than competing articles, then its container, by means of its label, color, shape, or other device, must provide counterparts of satisfaction which do not exist in competing articles. Hence commercial analysis is not confining itself to the commodity itself, but considers also the appearance of the commodity when it enters the market. Reference has

[4] P. W. Ivey, Elements of Retail Salesmanship, pp. 39-40, New York, The Macmillan Co., 1920.

already been made to the analyses which are being made of the store surroundings when the commodity makes its appearance on the market, and also the character of the service connected with its distribution. Both service-satisfaction and surroundings-satisfactions have their counterpart in the demand, and in reality become a part of the commodity in the customer's mind. Yet these latter analyses should not be confused with pure commodity analyses which seek to discover value or satisfactions which would otherwise remain obscure.

Counterparts of Satisfactions in Consumers.—The counterparts of satisfactions in consumers are known as buying motives or instincts. To study the extent and nature of these feelings, laboratories are being developed under the care of psychologists who understand the make-up of human beings and the sources of human action. Such investigators are determining more and more clearly the kind of advertising and selling appeals that are most suitable for connecting up the counterparts of satisfactions in consumers and merchandise. Laboratory tests of advertisements and sales talks are made with the intent of ascertaining what satisfactions the seller is attempting to emphasize—that is to say, what buying motives he is seeking to influence—and whether the counterparts of these satisfactions exist in the consumer in sufficient force to make an attempted connection worth while. If a satisfactory judgment cannot be arrived at beforehand, the advertisement is run or the sales talk is used, and the results of each are carefully tabulated and analyzed. From masses of such data it has become possible to predict with surprising accuracy the probabilities inherent in sales appeals of connecting counterparts of satisfactions.[5]

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[5] Tipper, Hotchkiss, Hollingworth, Parsons, Advertising, Its Principles and Practice, Chaps. 6, 7, 13, 40, New York, The Ronald Press Co., 1919.

Kinds of Markets.—While every advertising manufacturer desires a market for his goods the methods pursued in his sales appeals will depend on the exact kind of market he wishes to create. His sales appeals may operate from several different standpoints: reputation, uses, distribution, consumption, sales maintenance, trade-mark, education. Whichever of these markets it is most desirable to create, the selling plan can be worked out accordingly. Some definite kind of market should be the aim of all sales appeals, as only in this way can definite results be secured. At different times in an organization's history different markets will become necessary, and to recognize this need for change and make provision for meeting it is one of the manufacturer's marketing problems.

The ultimate, or consumer market may then be split up into several different kinds of immediate markets, the character of which will be determined by the nature of the sales appeal employed by the sales force, the advertising copy, or a combination of both. Some of the different kinds of immediate markets a manufacturer may desire to create are taken up in the following paragraphs.

A Reputation Market.—While the ultimate purpose of all sales appeals is to create a sales market or a sales maintenance market, the immediate purpose may be merely to create a reputation market. Harmonious relations with the public may often be maintained by analyzing the manufacturing and selling organization, and building up in the minds of consumers a vivid picture of this organization. Confidence being the basis of all successful business relations, a market for public confidence may be the chief preliminary requirement of a sales market. Public utility concerns in recent years have attempted through advertising to create such a market for their organizations, although they already had a monopoly

market for their commodity. They have created good-will for their organizations and secured much public sympathy. Recent advertising by the big packers has had as its aim the creation of a similar market. A bid is made for consumer-confidence in the methods and practices employed by these organizations, as opposed to the ill will stimulated by hostile critics. The creation of a reputation market is becoming of increasing importance as integration continues in the development of large-scale producers and distributors. In such cases, a sales market is entirely dependent in the long run on the thorough development of a reputation market. Which market will be emphasized at any one time depends on conditions of market emphasis.

A "New Use" Market.—When the ultimate market for the usual method of consuming an article is saturated, it may be possible to secure from commodity analysis new uses to which the article may be put, thereby resulting in new lines of consumption and a new sales market. This has become one of the most important developments in the creation of markets. The commercial research bureau has been a large factor in this development through repeated analyses of merchandise and its functions, and through keen appreciation of the possibilities thereby discovered. The advertising man has supplemented the research bureau through his understanding of the buying motives of consumers, which enables him to make an intelligent connection of the counterparts of satisfactions. Close contact with users of the product has also helped to solve the problem of a saturated market. The owner and user of a certain machine, when asked by the manufacturer to tell about its effectiveness, wrote a letter disclosing a secret worth several thousand dollars to the manufacturer—a new and formerly undreamed of function could be performed by reason of a slight alteration. There is little doubt

but that many new uses of almost any article could be ascertained by systematic study of what consumers do with it.

A Sales Maintenance Market.—The ultimate purpose of a sales policy may be to create a sales maintenance market, that is to say, a market in which repeat orders can be safely counted on. If the article is one that is purchased often, while sales may be increasing, this increase may be offset to a large extent by failure to repurchase on the part of old customers. Repeat orders represent a different market from first orders. The sales appeal must be different in each case. The repeat market—a sales maintenance market—may be developed by showing the advantages of continuous use of the product and the circumstances in which it functions most effectively. For example, a certain automobile polish was purchased in quart bottles by automobile owners who felt that they could not afford a new car or a new coat of paint. The sales appeal discovered a market for this product and was successful in selling it. However, the mortality rate of old customers was great although new customers were constantly being found. Not until an effort was made to show the correct manner of application and the advantages of continued use, was a sales maintenance market created.

A Trade-Mark Market.—The immediate purpose of the exploitation of a trade-mark may be to create a distinct market for the trade-mark itself. Perhaps the trade-mark needs individualizing; possibly emphasis needs to be placed on pronunciation or on some similar feature. Many trade-marks were created before the present buyer's market developed, hence they have quite frequently proved themselves inadequate from the standpoints of recognizability, memory retention, and identification. In order to remedy these defects the attempt is made to create a trade-mark market by means of

publicity. It should not be supposed that an attempt to create a market of this nature is developed independently of the creation of the sales market or the sales maintenance market. Often the different kinds of ultimate, or consumer markets are developed simultaneously by co-ordinated sales appeals, but even in this case, specific market analyses have to be made if the marketing of the product is to proceed logically and in the direction of complete market saturation.

An Educated Market.—It may be that a product cannot be completely distributed until the potential buying public has been educated along certain general lines which are no more intimately connected with this particular product than with the product of a competitor, or with some competing article. For example, a manufacturer of vacuum cleaners may stimulate people towards greater cleanliness and as a consequence sell more of his vacuum cleaners, but likewise increase the market of his competitors and perhaps of competing cleaners, such as brooms. This incidental disadvantage of such a campaign, however, may be far outweighed in the long run. Producing an educated market for one's goods may develop a consistent demand which will materially reduce the high operating expense caused by wide fluctuations between slack and peak distribution. Stability is given to the productive and distributing phases of any business when an educated market is created beforehand.

Summary.—It is thus seen that the manufacturer must carefully analyze the channels of marketing, whether they lead through the jobber and retailer to the consumer, or whether a more direct route is followed. Each middleman market discloses through analysis greater possibilities for more economical distribution of goods, while the consumer market is a complex of markets which depend on the nature

of the merchandise and the policy the manufacturer wishes to pursue. A systematic study of markets can be made only by specialists who are familiar with market phenomena and who know how to evaluate the multitudinous influences which have a bearing on the conclusions to be drawn. The intensive study of markets here outlined is necessitated by the development of a buyer's market, which makes it imperative that manufacturers know the extent to which various distributive methods will influence capacity production. It is only capacity production that can make possible the lowering of costs and the lowering of prices, with the consequent well-being for the community. Methods of production determine in the long run methods of distribution, although over a short period of time the latter may seem to dominate. The shifting relationship between production and distribution from time to time necessitates a change in different marketing machinery, and present methods of market analysis are parts of the new distribution machinery necessitated by present conditions.

CHAPTER XI

THE RÔLE OF ADVERTISING IN A BUYER'S MARKET

Comparative Efficiency of Advertising and Salesmanship.—Much has been said against the waste involved in advertising, with the attendant implication that a better quality of salesmanship would be less expensive and more efficient in selling goods. Whether one or the other should be used, in any particular case, for the marketing of goods, depends upon one consideration, viz., which will distribute the largest amount of goods with the least expense? Frequently from 100 advertisements of a commodity, only one sale results. Under such circumstances, advertising might be rated as 1 per cent efficient. If, on the other hand, a salesman had attempted to market the same product, he could perhaps have sold two orders out of three solicitations. In this case he would be considered 66⅔ per cent efficient. In other words, in the case where the product was marketed through the means of advertising there was a waste of 99 per cent, but if the product had been marketed by a salesman there would have been a waste of only 33⅓ per cent.

Such figures, however, have no significance when taken by themselves. The cost per unit of marketing a product may be less when advertising that is 99 per cent wasteful is used than when salesmanship under conditions of only 33⅓ per cent waste is relied upon. Competition dictates the use of the most economical method in marketing commodities, and very often where there is the most apparent waste and lost motion, the least cost per unit exists. Where goods can

be marketed most cheaply by means of advertising, even though of low efficiency, the problem is not one of substituting salesmanship for advertising, but one of increasing the efficiency of the advertising.

Relation of Advertising to Salesmanship.—Advertising should be viewed as a machine method of marketing goods, while salesmanship should be looked upon as a hand method. To sell certain goods, necessitates the personal touch of salesmanship; for selling others, an impersonal force, such as advertising, may be sufficient. The machine, or advertising, method excels in quantity distribution; while the hand, or salesmanship, method has the advantage in quality distribution. In other words, advertising markets goods in a wholesale way, whereas salesmanship markets them by retail methods. As long as goods are different in their nature, both methods of marketing are necessary and desirable.

Sometimes it is advisable at different periods of distribution to use both marketing methods on one product. For example, when typewriters first appeared on the market it was necessary to educate the people to their use by personal salesmanship. After the typewriter became an article of everyday use, advertising was resorted to more generally as a sales medium. The same has been true of aluminum cooking utensils, calculating machines, automobiles, and some other commodities. Advertising, however, is coming to be used more frequently as a missionary force. In so far as it can be substituted for salesmanship, it will eventually cut down the total cost of distribution.

Advertising not only follows salesmanship in distributing some commodities, but it may also precede salesmanship for the purpose of preparing the way for the salesman and minimizing work. Articles sold in retail stores are commonly advertised for this purpose. The customer is given

an idea of the nature of the product before going into the store, thus making necessary less salesmanship effort. Nationally advertised commodities invariably carry a lower margin of profit to the retailer because of this recognized lower expense of selling. In a very real sense they are partially sold before the customer comes into the store.

It is thus seen that advertising may precede, follow, or co-operate with salesmanship in marketing goods, or it may be used exclusively, or be excluded entirely. For certain kinds of goods and under certain circumstances both marketing methods have their advantages. For the most part they must be looked upon as co-operating rather than as competing distributing agencies. One can never entirely displace the other for they are fundamentally related. The most efficient system of distribution demands that commodities be delivered to the consumer at the least cost, hence advertising and salesmanship should be combined so as to accomplish this end.

Effect of Advertising on Competition.—Advertising stimulates competition. When a manufacturer decides to advertise, he exposes his product to attack. From the safe seclusion of verbal assertions and claims, the commodity is led out before competitors' gaze and exposed to scrutiny by means of written assertions, which may be subjected to analysis, neutralized, and refuted. Private claims, made by the salesman to the customer, may profoundly influence the actions of the latter, but whether or not such statements are true can only be determined by the counter claims of competitors, salesmen or by experience. Often the customer is influenced to purchase before salesmen from competing houses have a chance to point out possible defects in the commodity. Where advertising is used, however, one business can see the efforts of the other to get trade, and can accordingly present its rival claims in an effort to attract the consumer's sympathy. Com-

petition thrives best where the respective claims made for merchandise are known by all.

Advertising likewise places competition on a higher level. Without advertising, the attacks of competitors on each other's goods are usually haphazard, malicious, and not founded on fact. On the other hand, a salesman is less likely to condemn a competitor's goods if he knows something about them. Advertising brings merchandise out of the darkness of ignorance and suspicion into the light of fact and reason. Claims may, as a result, be based on the relative merits rather than on the relative demerits of competitive goods. With advertising as a background, salesmanship attains a new dignity, since published assertions can be utilized instead of meaningless superlatives and generalizations.

The customer profits materially from the increased competition caused by advertising and its elevation to a higher plane, for he is given an opportunity to compare the relative merits of competitor's goods, and to judge impartially as to their values. The conclusions reached from this weighing process come much nearer the truth than any judgment formed without the influence of publicity.

Advertising as a Creator of Value.—It is a common error to believe that value is inherent in an article. Value does not reside in merchandise, but in the mind of the customer. In other words, it is a mental concept. The function of advertising is to create value, i.e., to build up in the mind of the reader a high regard for the goods. To accomplish this end expeditiously, every characteristic of the goods must be known, as well as their relationships to closely related facts. Such a process necessitates digging up facts. It also means the co-ordinating of facts. Both of these operations are creating the goods in just as real a sense as did the workmen and machinery which originally fashioned them.

The extent to which the advertisability of the article can be developed depends upon the ingeniousness of the advertiser. The Beech-Nut products are made more valuable in the consumer's eyes by attractive description of the plant atmosphere in which they are produced. The flood of bright light; the immaculate rooms; the well-groomed, cheerful, manicured employees; the sense-satisfying odor of the ingredients; the inviting restrooms for employees; the benevolent management; and many other conditions surrounding the manufacture of these products are made part of the products by the advertising appeal, and increase their value to the consumer.

Distinguishing Similar Products.—It is very often difficult to find an element of value in a commodity that a competing article does not possess. Yet unless some distinguishing characteristic is found, the commodity is lost in the dull uniformity of other competing brands. In some cases where the product apparently has no distinguishing element of value, the clever advertiser has created one. Colgate's tooth-paste illustrates the point. With many tooth-pastes of similar quality and effectiveness on the market, it was necessary to create some feature which would give it a personality all its own, and thus an added value. The distinguishing point that was developed pictured the paste coming out of the tube like a ribbon and lying flat on the brush. This was an obvious advantage over tubes that were not so constructed, and illustrates the creation of a value as regards the use or application of the product, rather than a value inherent in the product.

Another illustration of the same point is that of Log Cabin syrup. A unique can, shaped like a log cabin, creates a distinguishing characteristic which adds value to the product. Furthermore, the log cabin suggests the freshness of the forest, the dripping of the sap, the boiling, the sweet odors from the kettle, the genuineness and purity. The syrup thus

takes on characteristics suggested by the can. Value in the product is thereby created just as truly as when it was manufactured. There is no intrinsic value in this or any other syrup; the value the customer does not see, for him does not exist.

Advertising thus continues creating value where the value-creating manufacturing process leaves off. The advertised value supplements the manufactured value, and often the latter would be largely lost if it were not for the former. Advertising, therefore, preserves value as well as creates it. When the product leaves the factory it is only partially created —only a small fraction of its potential value attaches to it. Advertising must bring out the balance of value, not merely to make the customer buy, but also to preserve what value has already been created in the commodity in the factory.

Effect of Advertising on Unadvertised Goods.—Advertising articles of a certain class tends to increase the sales of unadvertised articles of the same class. Thus, the advertising of one brand of vacuum cleaner tends to sell more of other brands. People become sold on the idea of a vacuum cleaner through advertising, without becoming unalterably opposed to purchasing a brand other than that advertised. The sale of the idea of this method of cleaning is therefore valuable to every manufacturer who is contemplating placing vacuum cleaners on the market.

A more interesting fact is that advertising articles of a certain class tends to increase the sales of unadvertised articles of another class performing a similar function. Thus, the advertising of vacuum cleaners increases the sales of brooms. This illustration goes back a step further than the example cited in the preceding paragraph. Selling the idea of vacuum cleaners is primarily selling the idea of cleanliness, and sweeping with brooms is one way of securing this desirable end. In

advertising any product, it is often necessary to impress the reader with a fundamental idea which is applicable to competing articles of the same class, or of another class performing similar functions. Advertising thus unavoidably affects the sale of products unadvertised, and creates value for objects with which the advertised commodity is only distantly connected.

Advertising as a Demand Control.—Overproduction and underproduction have usually occurred because the manufacturer was, (1) unaware of the tendency of the demand, or, (2) if aware of the tendency of demand, he was powerless in many cases to exert any control over it. Demand as a rule does not just "grow"; it is the result of cultivation—of intensive effort, making use of specialized devices, such as salesmanship, advertising, and reputation. When demand can be created for the output of the factory, both ends of the productive process may be co-ordinated. There are times, however, when factory output, not demand, is the limiting factor in the productive process. At these times of underproduction, the amount of advertising is reduced and demand falls off. An illustration of underproduction for a demand which might be created, is that of the Rubberset products. Little or no new demand is being created because the present demand absorbs all the products that can be made. An increase in the advertising appropriation of this company would swamp their plant with orders which could not be filled. Such a creation of demand would not only be a waste but worst of all a loss of good-will. To preserve present value, advertising is being used scantily for a time. With increased producing facilities in the future, it may again become possible to manufacture demand as well as goods.

Advertising thus prevents waste by avoiding overproduction and underproduction in factories. It promotes factory

efficiency by enabling each individual plant to operate in that stage which is the most effective. Many plants have unused utilities within themselves, which, if used, would reduce the per unit cost of production. In other words, they are capable, with increased production, of getting into the decreasing cost stage. On the other hand, it may be just as desirable to curtail demand so that the costs per unit of product will not rise unduly in comparison with the costs of competitors.

Relation of Advertising to Traditional Marketing Method. —The traditional method of marketing is from manufacturer to jobber, from jobber to retailer, from retailer to consumer. Recent schemes have attempted to eliminate either or both of these middlemen. Obviously, where a link in the marketing process is removed, more pressure is brought to bear on the other links. In other words, while a middleman may be eliminated, his functions or duties cannot be. Such being the case, advertising has been introduced in order to take over some of the duties formerly carried by the eliminated marketing unit. One of these important duties is to find a market for the goods. Another is to stabilize the market after it has been secured. It has been a well-recognized function of advertising, to relieve some of the overworked remaining middlemen.

Can advertising, however, be used economically in the traditional system of marketing where no middlemen have been eliminated? If so, how will it be used, and where will a saving be effected? Advertising is looked upon suspiciously in the traditional system because it is believed that it results in adding more expense to the distribution cost. Such a result does not necessarily follow. Even with the jobber included in the distribution system, the manufacturer's advertising may cut down the total costs of marketing, and in so far as it does, it is entirely justified.

This reduced expense may first appear as a result of the attitude taken by the jobber toward the manufacturer who advertises. If the jobber is assured that there will be a large and steady demand for the manufacturer's goods, he will be much more inclined to push them, thus increasing the outlet for the manufacturer. Enlarging the outlet for the manufacturer's merchandise may reduce his overhead expense per unit of product, and under competitive conditions, he will be inclined to share part of this reduction with the consumer. Advertising in such cases reduces the marketing expense, and finally the price of the goods.

Advertising reduces also the expense of retailing, as shown by the fact that the retailer gets a less margin of profit on the advertised articles. Moreover, the retailer is stimulated, by the consumer-demand created by the advertising, to specialize on merchandise with a quick turnover, thus eliminating costs which usually accrue because of dead stock. This saving under competitive conditions, will, in the long run, be shared with the consumer.

Trade-Names.—A manufacturer who expects his advertising to function freely and efficiently, must consider a great many factors. One important consideration is an adequate name for his product. Many commodities have suffered in competitive advertising because they have been hastily and inadequately christened. Where articles are not to be marketed by means of advertising, it is not so important to give them at the start an adequate name, because the name can be changed later with little loss of good-will; but where the name is to be carried into nearly every home in the distribution territory, a change in name is a matter of serious consequence.

The first prerequisite of an adequate name is that it should be distinctive. There are dozens of Ohio, Standard, Union, and National brands on the market. It is too much to expect

that advertising can successfully market commodities which are thus handicapped at the start. The consumer becomes bewildered upon seeing so many products with the same name, and its lack of distinctiveness permits much substitution and general confusion for which advertising is not to blame, and for which it cannot offer a remedy. If the name of a commodity does not stand out, it is defective as a marketing device, and advertising can only heighten the defect, for it is possible to advertise a defect as well as a virtue.

The second prerequisite is that the name of a product should be easy to pronounce. "Prophylactic," "Glycothymolin," and similar names have never sold an article; the goods so named have been sold on their merit and in spite of their names. "Bon Ami" is daily being pronounced in six different ways, and the employees in the factory where it is made use all six different pronunciations. Foreign words or phrases are especially undesirable, because such a small percentage of the people know the meaning back of the words. A word which cannot be quickly and easily pronounced is not the one to designate a product which is to be marketed by advertising. Customers do not like to be corrected by the salesperson, and many cases have been known where some other brand has been asked for simply because the customer did not desire to take any risk of humiliation.

The third prerequisite is that the name be easy to remember. It is of little consequence to have one's attention attracted by a name, or to be able to pronounce it, if it is not readily remembered when the object is thought of. The advertising may be of the best, but its efficiency as a marketing force is materially reduced if the name is not built on psychological principles. An inefficient name is a leak in the business as much as a loss through theft. Only too often advertising is blamed for failure to get distribution for a commodity, when in reality the fault lies with the conditions against which

the advertising has to work. Not only must the product have merit and the advertising be good, but the name of the product must be such as to become associated in the minds of customers with the object it stands for.

Other Factors of Advertising Efficiency.—The package must likewise be looked upon as an important marketing device. It should be so distinctive that it attracts attention and is easily recalled. If possible, its shape, color, or general appearance should suggest the product itself, and in this way, be an active selling agent. The advertising of a product enclosed in a package which suggests the product is always more efficient than is the case if little or no attention is given to the package as a marketing device.

The price must be within the means of the class of people who are expected to purchase the advertised product. A price that is too high, as well as a price that is too low, places advertising at a disadvantage. A large number of the class that should be appealed to are excluded from considering seriously the product if its price does not conform with their concepts of value. Like the package and the name, the price is a marketing device which is potentially a help or a hindrance to the efficient distribution of goods. It may be that at first the price must be placed below cost, with the expectation that an increasing demand will reduce the costs per unit of product and enable not only the costs to be secured out of the selling price, but likewise a legitimate profit. The whole marketing situation must be analyzed if there is to be no undue handicap placed on advertising.

Another important factor is the geographical area of distribution to be secured for the product. Many a manufacturer has effectually closed the door of advertising to himself by securing too wide a distribution for his product at the start. If the consumption of a product is widely scattered over the

country, it is impossible for advertising to further its distribution economically. The costs of undertaking an advertising campaign which would cover the entire country would be too great for the returns secured. The product would have to be left to its fate, without any aid from the outside. Where the market, such as a state or a country, is intensively cultivated through jobbers and retailers, however, a most effective and efficient advertising campaign can be inaugurated, which may be capable of maintaining or increasing the distribution at a lower cost than could be done by other marketing forces. This is true because of the possibility of using only the mediums which cover the territory.

Relation of Demand to Distribution.—A controversy has raged in some quarters as to whether demand should precede distribution or vice versa. The answer to the question is that they should both proceed simultaneously. To build up demand through advertising before distribution has been provided through the jobber and the retailer, is to lose much of the initial force of advertising; while to develop distribution through the middlemen before consumer-demand has been stimulated, is to lose the confidence of the retailer and jobber because of the slow-turning products which they have accumulated.

This does not mean that advertisements should not be run before the products are placed in the channels of distribution. It merely means that demand should not be created without ability to satisfy it readily. Possibly advertising may need time to develop a satisfactory demand, in which case its actual appearance must obviously precede the introduction of the goods. On the other hand, it may take longer to effect an adequate distribution of the goods than it does to create a demand sufficient to absorb the supply. The whole point to the matter is that when a demand exists a distribution should

likewise exist. They are part of each other and cannot exist efficiently without each other.

Much waste in marketing occurs because these two factors are not correlated. An article is advertised as being "found at your grocer's." On going to the grocer's, he expresses ignorance of the product, but suggests that he has something "just as good." Perhaps the advertisement may have said that if the article was not to be found at the local grocery, it could be obtained by sending the retail price in postage stamps to the company's office. Only one out of a hundred people who have been taught by the advertisement to demand the article will go to this trouble, and soon the matter is forgotten and a substitute article comes into use. All such wastes are ultimately paid for by society, and, therefore, it is to the interest of consumers in general to co-operate with present-day marketing agencies in eliminating all such inefficiencies.

Selling the Retailer and Jobber.—Many advertising campaigns have a large element of waste in them because they rely primarily on selling their idea to the consumer, and overlook the retailer. Experience has proved that very few products can be so effectively portrayed before the eyes of consumers that substitution cannot be accomplished by the retailer. The latter is personally in touch with the customer and can belittle a competing advertised product without fear of rebuttal. Salesmanship has an advantage over advertising which the latter must recognize. When the pressing of this advantage is stimulated by the efforts of the jobber who is offering a private brand with a larger margin of profit to himself and the retailer, the advertising manufacturer may well consider the necessity of selling the idea of his product to the retailer and jobber at the same time that he is selling it to the consumer.

Because advertising manufacturers are recognizing this

necessity, they are sending out traveling salesmen whose purpose is not so much to sell the goods as to sell the idea of the goods. The retailer must have confidence in the merchandise and desire to handle it, even though it carries a lower margin of profit than some obscure brands that he might be able to get to fill the same demand. The consumer-demand cannot force the retailer to stock his shelves; he must voluntarily do that on the basis of a belief in the goods and in his ability to make a profit from them. The jobber must likewise be induced, not coerced, to push the advertised goods. The jobber has always found methods of side-stepping coercion. His loyalty to the manufacturer must have a material as well as a sentimental basis.

CHAPTER XII

THE INCIDENCE OF ADVERTISING COSTS

Lack of Scientific Analyses of Subject.—The incidence of advertising costs has from time to time been given some space in trade papers and has been discussed by advertising men at their conferences. Despite these activities, little of a scientific nature has been brought out concerning it. Contradictory opinions and statements regarding the ultimate location of advertising costs have tended only to confuse the situation. Hart, Schaffner and Marx tell their dealers that they are able to keep their prices down because of the large distribution that results from advertising, while on the other hand, a small competitor of this house tells its trade that it can undersell Hart, Schaffner and Marx because it does not have to burden the prices of its men's ready-to-wear apparel with advertising costs. Moreover, that a great many people believe the consumer always pays for advertising can be verified by questioning those about us. As to what they mean by saying that "the consumer pays for advertising," it is not always apparent to themselves or to others.

The Two Implications of Incidence.—In view of what has been said, it is necessary in attacking this problem to ask what is meant by the question, "Does the consumer pay the costs of advertising?" This question may have either of two meanings: (1) whether or not consumers taken collectively pay for all the expenses of advertising viewed in the aggregate, and (2) whether or not the consumer of a certain article always pays for the expense of advertising that article.

In discussing what is involved by the first meaning, very little time need be spent. It is obvious that all the expenses of distribution, which include advertising expense, in the United States, or in any state, town, or store, must be met by the aggregate income of the unit considered. To say, from this viewpoint, that the consumer bears the costs of advertising, is merely to state a truism. All persons are consumers, and taken collectively, must meet all the expenses of distribution. It seems quite certain, therefore, that this meaning is not the one usually attached to the question under consideration.

The usual meaning then of the question, "Does the consumer pay the cost of advertising?" is, "Does the consumer pay for the advertising on the article he buys?" An adequate answer will necessitate a brief consideration of price fixation under five different conditions of distribution:

1. Constant cost
2. Increasing cost
3. Decreasing cost
4. Fixed supply
5. Joint cost

These conditions of distribution may prevail in industries as a whole, at any given time, or in individual manufacturing establishments at different periods of their activity.

1. Distribution Under Constant Costs

Definition of Constant-Cost Goods.—Constant-cost goods may be defined as goods of which the cost of distribution per unit remains constant between certain limits of increased or decreased distribution. Many manufactured products reach the ultimate consumer under these conditions. For example, a certain patent safety pin can be distributed at the same cost per pin whether 500,000 or 1,000,000 safety pins

are distributed. If there were a demand for more than 1,000,000, there might be a slight increase in cost, but this new cost figure would remain constant between limits of distribution, let us say, 1,000,000 and 1,500,000. Similar conditions to these hold true for a large number of sales organizations.

Cost is the main determinant of the price of a constant-cost article—the demand for the article being assured—and the question whether the consumer of such an article pays for the advertising of that article resolves itself into this: Does the advertising appropriation increase the distributing cost per unit of a constant-cost article? The answer must of course be in the affirmative, since no matter how extensive a distribution of the article is effected through advertising, the distributing cost per unit increases to the extent of the advertising costs; and since the costs of distribution are higher than before the advertising appropriation was made, the selling price must be correspondingly higher. Whenever the consumer is unwilling to pay this higher price, the article is withdrawn from the market, distribution is cut down, and production eventually stops. This ability to withdraw the supply from the market is, of course, the vital factor in upholding the price level. Under competitive conditions it cannot always be effected so promptly as under monopolistic control, but even in the former case it is no doubt true that industry, often quite promptly, readjusts itself and produces that which is demanded at a price which will cover all costs.

Non-Advertising Competitors.—The above situation assumes that competitors working under constant-cost conditions, are all advertising in order to increase their distribution. The opposite situation might, however, be true. Some competitors may have lower distribution costs because they are not advertising, and because of the resulting lower selling

prices, may put the advertising firms out of business or make them reduce their advertising expenses; especially if the demand can be supplied by the productive capacities of the non-advertisers. But with increased demand, the constant-cost manufacturers who are advertising may be compelled to supply a very important part of the demand. They can then increase their distribution by advertising and shift their advertising expenses to the consumer by raising selling prices.

Other manufacturers working under these cost conditions, who are not advertising and whose distribution costs are therefore not as high as the distribution costs of the manufacturers who are advertising, will nevertheless raise their selling price to the level of the manufacturers with the greatest distribution costs, and in this way make an extra profit. Here would be a case where not only the price of the article has risen to the extent of the advertising costs incurred by a few manufacturers, but also where a large sum, not attributable to advertising costs, is secured from the consumers of these articles by manufacturers who are not advertising. Hence, the consumers, taken collectively, pay more than the total costs of advertising, as well as the total of old costs; while the consumer, taken individually, pays only the old distribution costs plus the advertising costs.

Incidence under Excessive Competition.—If the increase in demand appears to be of a permanent nature, the entrance into the market of new manufacturers becomes a certainty. Whether or not these new manufacturers advertise depends upon a great many circumstances, but chiefly upon the intensity of the demand relative to the supply of this kind of goods. If the new manufacturers are more numerous than the demand warrants, each of them will endeavor to control the market. Advertising will probably be one of the means to this end, and the immediately resulting price will most likely

not be high enough to include all advertising costs. Therefore, manufacturers of advertised constant-cost goods must either lose money for a time, with the hope of driving weaker competitors from the market, or they must cut down their advertising appropriations.

In either case, the consumer does not pay the costs of advertising. As the stronger organizations, however, force the weaker out of business by lowering prices below distribution cost, they are able to raise their selling price to cover all distribution costs, including advertising. Large organizations, while enjoying no immediate reduction in unit distribution costs through advertising, nevertheless continue to advertise in order to hold the market against all newcomers. They hold the market in the hope, also, that large-scale distribution will ultimately permit distribution under decreasing cost conditions, and thus lay a permanent basis for larger profits.

2. Distribution Under Increasing Costs

Definition of Increasing-Cost Goods.—The second condition of distribution under which some sales organizations of factories work is that of increasing costs. By saying that goods are being distributed under increasing costs, we mean that costs of distribution per unit of product are increasing more than proportionately to the increase in units distributed. This classification might seem less important than the others, since it might be presumed that no sales organization would distribute for any length of time under such inefficient conditions. This however, is not true, since many sales organizations of manufacturing establishments pass through this stage of distribution in emerging from constant-cost distribution, or before going into decreasing-cost distribution; and many of them often distribute for long periods of time under these conditions, for various reasons, such as delay in securing

capital to increase the distributive facilities, or because of sluggishness of demand which necessitates the continuing of the old distributing capacity.

Marginal and Supramarginal Manufacturers.—Many of these manufacturers, by reason of better sales organizations and more up-to-date methods, are distributing at a less cost than others. These men who are distributing at a less cost might be called supramarginal manufacturers, and the men who are working under increased inconveniences and with less progressive distributive appliances, and whose costs are therefore greater, may be called marginal manufacturers. If only 80 per cent of the total product demanded can be distributed by the supramarginal manufacturers, the remaining 20 per cent must then be distributed by the marginal manufacturers; in which case the latter are absolutely necessary to satisfy the demand for the product from this industry. Because of this fact, their cost of distribution will determine the selling price of the article, since the highest distribution costs must be met if this 20 per cent of the product is to be forthcoming. As the cost of distribution of the marginal manufacturers is greater than that of the supramarginal, and the selling price the same for both, it follows that the latter class of producers will be making a greater margin of profit than the former. As distribution at increasing costs has been assumed in this case, there would not be much incentive to increase distribution by means of advertising, but there might be a strong incentive to hold the present market or to cut down selling expenses by means of publicity.

Advertising Expense When Included in Selling Price.—Why are supramarginal manufacturers more efficient? Why are their costs of distribution per unit less? There may be a great many reasons for the existence of these conditions,

but perhaps one cause for their lower distribution costs is the fact that they are carrying on an extensive advertising campaign. And, conversely, it is probably true that the distribution costs of the marginal manufacturers are high because these producers have a poor sales organization and have not reduced their distribution expense by an aggressive advertising policy. It is clear, then, that the unit of distribution cost of the marginal manufacturer may not include any expense for advertising. Yet it is this distribution cost that fixes the selling price. Thus it is seen that the selling price may have no element of advertising expense in it, and in such cases advertising costs would not be paid by the consumer.

As has been said, all the supramarginal manufacturers, by advertising, may have decreased materially their costs of distribution or may have succeeded only in holding the market against others. If forced to, they could actually sell their product for less than they do, because their distribution costs per unit of product are much less than those of the marginal manufacturer; but since the demand cannot be met by these supramarginal manufacturers alone, these producers are reluctant to reduce their selling price to meet their lower distribution costs until competition forces such a reduction. If, however, the demand for this product should drop 20 per cent, the marginal manufacturers would be the first to leave the market, in which case the demand could be supplied entirely by the supramarginal manufacturers. Competition among these more efficient manufacturers might then enter in, and the selling price would probably be reduced to the new costs. Of course, in this case, the selling price would actually include the advertising appropriation.

Deferred Payment of Advertising Costs.—The increase in costs per unit as a consequence of greater distribution may not

be shifted immediately by the supramarginal manufacturers to the consumer, due to keen competition or lack of good-will, but may be considered as promotion costs and spread over a period of years or treated as an investment. There seems to be a growing tendency to treat as an investment advertising costs which increase good-will but which cannot be immediately recouped in the selling price.

Of course, advertising costs which merely maintain distribution should be considered an expense. The same is true of advertising costs which seek primarily to secure distribution. This applies to goods which are purchased only once or twice in a lifetime With these goods, if a competitor gets the one sale, the manufacturer cannot hope to sell that person again. If, however, merchandise is of such a character that it is quickly consumed, even though a competitor gets the first sale a second soon becomes possible, and the manufacturer's advertising which secures this may justly be called good-will advertising and treated as an investment.

Many manufacturers at different times in their history have treated advertising in this manner, and have later written off the good-will item when the anticipated future earnings materialized. In these cases, the consumer of these products did not pay for the advertising costs; these were finally absorbed by lower per unit distribution costs when the organization reached the stage of decreasing costs. Other concerns have left the good-will item in their balance sheets and have only taken out of operating expenses interest on this amount. Hence, consumers have paid for only a portion of the advertising costs in these cases.

3. Distribution Under Decreasing Costs

Definition of Decreasing-Cost Goods.—The third classification of distribution is that of decreasing costs. This classification is perhaps more important than all the rest, because

a very large percentage of manufactured goods are distributed under decreasing costs. In industries where this is true, the cost of distribution per unit of product decreases more than proportionately to the increase in units distributed. Examples of decreasing-cost industries are to be found in many large plants where all the distribution utilities of sales organizations are not fully utilized. For instance, in the large sales organizations of the packers, distribution can increase between wide limits and still show a continuously decreasing cost per unit of product.

Price Determinant.—In this classification of industries there are likewise marginal and supramarginal manufacturers; in other words, those who are working under the most adverse circumstances—under the highest distribution costs—and those who are working under more favorable conditions, with less distribution expense per unit of product. From the standpoint of price-fixation decreasing costs are the reverse of increasing costs, because under the former condition of distribution the price is fixed, not by the manufacturers who distribute to the greatest disadvantage, but by the largest and most progressive manufacturers. If there is any increased demand for the product, the supply to meet it would naturally come from the larger plants, where a more complete utilization of the fixed investment in distribution facilities would decrease the costs of distribution per unit of product and enable these manufacturers to lower their selling price. On the other hand, since the smaller establishments are often unable to lower their distribution costs in the same proportion they drop out of existence, and resign the market to the larger concerns which are able to hold it by still further increasing their distribution, lowering their distribution costs and their selling price, and stimulating and developing new increments of demand.

Where Consumer Bears Expense Levies.—Does the consumer of decreasing-cost goods pay for their advertising? Since this classification comprises many of the goods daily consumed, it may be well to spend a little more time analyzing the possibilities of the situation. To begin with, the principle may be laid down that any charge or expense levied against an article is only borne by the consumer when the effect of such levy is an increase of price. Thus a tax of $1 on each pair of shoes, having a distribution cost of $5, would make necessary a distribution price of $6. In this instance, the price of a pair of shoes rose from $5 to $6, hence the consumer pays the tax. Again, suppose a law made necessary the introduction of devices to protect employees from being injured by machinery. This new levy against the product would most likely result in an increase of price to the consumer, since it would not enlarge the distribution of the article. If the new levy of expense could have resulted in a wider distribution of the article, and if the overhead did not increase proportionately to the increase of distribution, then there would have been a *less* distribution charge against each unit of product; in other words, the distribution cost of each unit would have been reduced. Now, if competition were active, the selling price would be forced down to this new cost, and instead of being higher because of the new levy of expense against it, the price would actually be lower than it previously had been because the distribution cost was lower. Hence the consumer would not be bearing the new levy of expense.

Advertising Expense and Distribution—Ratio of Increase.—As regards advertising, can it be shown that it actually increases the distribution of some goods, and that in these cases overhead does not increase in the same proportion as the increase of distribution? If these two points can be shown conclusively, then it is true that the distribution cost per unit

is decreasing as the distribution increases, and with active competition, the selling price will tend to fall toward the cost price. The phrase, "tend to fall," is used because it might be some time before competition would become strong enough to affect the market. But when this competition becomes able to meet a large part of the demand, it could afford to lower its prices to meet its decreasing distribution costs; and the other manufacturers of goods would have to follow suit or be forced out of the market, all other conditions of quality, service, and the like, being equal.

Effect of Advertising on Costs.—That advertising increases distribution for decreasing-cost goods, resulting in lower per-unit production and distribution costs, is a fact that can be verified by many concrete instances.[2] The example of carborundum is a case in point. In 1893 a chemist in a little town in Pennsylvania accidentally created carborundum. He was experimenting with electric current, which he introduced into an iron bowl containing some clay and crushed coke. When the carbon was removed, he perceived that tiny, shiny, blue crystals stuck to it. He found that they were as hard as diamonds and could be used to polish gems. Before this time, diamond dust, selling at 70 cents a carat, was used for this purpose; but it was now displaced by carborundum which could be produced for 40 cents a carat, or $880 a pound. With a narrow market it would be difficult to reduce

[2] As regards costs, a commodity may be considered from the standpoint of production as well as of distribution. If the former standpoint is considered, a decreasing-cost commodity may be defined as one, the costs of production per unit of which, decrease more than proportionately to the increase in the number of units produced. An increase in volume, therefore, as regards some commodities, tends to reduce the per unit cost of manufacture as well as the per unit cost of distribution. An industry in which an increase in volume has both these effects may be termed a double decreasing-cost industry, and a commodity produced in such an industry may be termed a double decreasing-cost commodity. It is possible, of course, for a product to be manufactured under a different classification of costs than it is distributed under and vice versa. In such instances, any reduction in per unit cost of distribution due to volume may be offset by an increased cost per unit of manufacture, or vice versa.

the unit cost of production. A wide demand had to be secured, new uses had to be found, which could be accomplished only when the merits of the product were thoroughly known. With this purpose in mind, advertising was extensively used; and, as a result, demand rose at a rapid rate, necessitating new methods of production, since the productive capacity heretofore had been only 50 pounds a year. How advertising and intensive selling methods acquainted the people throughout the country with the merits of this article, is a story that reads like fiction. Suffice it to say that because of the demand for this product, which eventually became enormous and which permitted large-scale production, and because of internal economies, the production and distribution costs fell. The selling price per pound dropped successively from $880 to $440, then to $10, while in 1919 it sold for 12 cents. A drop from the price of diamond-dust to the price of common emery in a period of 24 years was the result, at least to some extent, of educating the public to the uses to which carborundum could be put.

Effect of Advertising on Prices.—According to our premise, the consumer only bears an expense levied against an article when the price of the article is raised directly because of that levy of expense. Now it has been shown that in some cases prices fall because of a levy of advertising expense, and under such situations it is difficult to see how the consumer is bearing the expense, as some have maintained. It might be said that the new price set by competition, after advertising has done its work, embraces the costs of production and distribution, and since advertising is one of these costs, consumers must pay this cost as well as all others. It does not mean, however, that consumers are being burdened, as the phrases, "bearing the cost of distribution," or "paying for advertising," imply.

In this connection, it might be asked whether the consumer of shoes and clothing, in the middle of the last century, "paid for" the expenses incident to the introduction of the sewing machine. He secured his shoes and clothing at a lower price and they were of better quality and workmanship. It might be more accurate to say that he profited by the change in methods of production rather than to say that he paid for them. The consumer paid nothing extra for shoes and clothing; in fact, he paid less for them. And so at the present time, if there is an introduction of a new and economical method by which distribution of goods can be increased materially without a proportional increase in expense, then mankind is benefited and pays lower, not higher, prices.

No one will hold that increases in efficiency of distribution are any less desirable than increases in efficiency of production. No matter how efficiently goods can be produced on the sewing machine, if they cannot be distributed economically prices to the consumer will be high. New inventions for making distribution efficient are only recently coming to the front, because the emphasis to date has been laid on increasing the effectiveness of production. But when it is realized that a large portion of the selling price of any article consists of the expenses of distribution, it must be evident that new distribution methods are necessary if the prices of necessities are to be reduced and the use of luxuries increased among a larger number of people.

In analyzing this question of whether the consumer of decreasing-cost goods pays the cost of advertising them, two situations must be recognized. The first situation is one in which distribution has been increased without increasing the overhead charges proportionately. During the early stages of this period, there is no doubt a time when competition has not become active. If price is not reduced, it might be said that the consumer is paying for the advertising. But it would

be more accurate to say that the consumer is paying high prices because of lack of competition, or because of temporary monopoly. As competition becomes more effective, the price falls to meet the new costs. Advertising brings about this fall in price, because no matter how much the monopoly might have been broken by competition, the price could not have fallen if the distribution costs had not been reduced because of the wider distribution that resulted from advertising.

Eliminated Advertising Expense—Effect on Consumer.—The second situation is one in which the prices have ceased falling and a new standard of prices has been set up. Suppose the price of the article was formerly \$2 and is now \$1.25. If the advertising expenses are included in the cost of distribution, are they not added to the price that the consumer has to pay? To state this differently, would the consumer pay less than \$1.25 if advertising was not included in the expenses of distribution? The answer must be in the negative, because in many cases, if advertising were discontinued the distribution would fall off; and since the overhead would not decline in proportion to the decreased returns due to falling sales, the distribution cost per unit of product would increase. With rising distribution costs, selling prices would have to rise—hence the consumer would have to pay more than \$1.25. If the producer did not increase his selling price, he would have to go out of business on account of his rising distribution costs. If on the other hand he did increase his selling prices, his competitors who had a lower distribution cost per unit because of advertising would undersell him, and he would have to reduce his prices to their former level. Hence he could stay in business upon one condition only, viz., that he increase his distribution to such an extent that his distribution costs per unit of product would enable him to meet his competitors' prices on the open market.

That the distribution would fall off in a great many cases were advertising discontinued, is a fact substantiated by much concrete evidence. A well-known example is the decreased distribution of St. Joseph's Oil. This product had an exceedingly wide distribution when the president and owner of the business died. His estate was desirous of cutting down all unnecessary expenses connected with the business, and unfortunately placed advertising expenses in this class. Old advertising contracts were not renewed and new ones were canceled. Quite soon St. Joseph's Oil no more graced the pages of the country newspapers and other periodicals. With the disappearance of advertising, sales began to decline. It was only a matter of months when this well-known product had merely a local demand, while distribution per unit costs rose tremendously.

Advertising a Cost, Not a Burden.—Finally, however, if the critic pins us down to the one point, viz., whether the $1.25 does not actually include the advertising costs, just as it includes all salaries, rent, light, and so forth, we shall be compelled to assent. The $1.25 does include the advertising costs as well as all other costs. Does the admission of this fact, however, leave the implication that advertising is a burden upon the consumer? It may, or it may not. The popular interpretation of the word "costs" is that it denotes inutility, irksomeness, a weight on distribution, a burden. If this conception of costs is dominant in the minds of people, then to say that the consumer pays the costs of advertising is misleading.

Failure to Advertise—Effect on Consumer.—On the other hand, if it is seen that advertising instead of being a "cost," in the usual meaning of the word, is really a device by which costs of distribution are reduced, then would it not make the

situation clearer if it were said that the consumer would pay for failure to advertise, rather than that he pays for the advertising? But if the consumer of a decreasing-cost article pays more money for it simply because the producer failed to advertise it adequately, how can it be said, when this article is advertised, that the consumer pays for its advertising, when he actually secures the article for a less price—due to advertising?

The only way out of this dilemma is to recognize that all distribution costs, including advertising, are included in prices of decreasing-cost goods; but if it were not for the advertising expenditure the consumer would pay more for commodities of this nature. In other words, consumers of decreasing-cost goods "pay" for all improvements in technique of their production and distribution, but they would pay more if such improvements were not made.

CHAPTER XIII

THE INCIDENCE OF ADVERTISING COSTS
(CONTINUED)

4. DISTRIBUTION OF FIXED SUPPLY

Definition of Fixed Supply Goods.—The fourth condition of distribution to be considered in a discussion of the incidence of advertising costs is that where the supply of goods is fixed. Fixed-supply goods present a very interesting classification. They may be defined as goods that are fixed in amount relative to demand. An instance of this may be found in the case of houses in a town that is growing so rapidly that houses cannot be built fast enough to take care of all newcomers, or in a town declining so rapidly that the houses cannot be taken off the market as fast as people move away. Examples of goods absolutely fixed in supply are: rare paintings, old postage-stamps and coins, out-of-date stocks of goods, autographs of men who are dead, books out of print, land (in some cases), antique oriental rugs, and the like.

Strength of Demand.—No matter what the demand for goods of this nature, it is impossible either to increase or decrease the supply. Price in these instances is not fixed by cost, but by the value that consumers place on the goods. We see merchants selling last season's ladies' suits for $32, although they actually cost twice that amount. Men's hats that at the beginning of the season would have brought $8, may at the end of it sell for $3.50. Whatever price these

old stocks sell for rests largely with the consumer. The same holds true with old coins and postage-stamps, antique furniture, and oriental rugs. What these articles sell for depends on whether people are making collections of them—perhaps because of some sentimental value they attach to them—not on cost.

Now if these articles are advertised, costs of distribution may or may not be increased; but since costs are not the determining factor in fixing price, the consumer does not necessarily pay for this expense. The word "necessarily" is used because it is altogether probable that the owner of the articles will get all expenses connected with their distribution, if demand is intense enough to warrant a price to include them. But it is just as true that no matter what expenses he has undergone, these cannot be shifted to the consumer unless the consumer's desire will warrant their payment; or possibly, unless the fixed-supply commodity is controlled by a monopoly, and can be placed on the market in small amounts in such a way as to cause an artificial scarcity and make a relatively more intense demand for the limited stock. By this latter method, even though only a portion of the stock is sold, the gross receipts might be large enough to cover all expenses incident to handling; whereas, if the entire stock had all been sold on the market at once, loss might have ensued. Such methods have been adopted by banana, cotton, and tobacco producers, whose goods are fixed in supply between seasons. A portion of the stock of perishable goods has, in some instances, been destroyed in order to insure gross returns on the balance of the supply large enough to pay expenses.

Nature of Goods.—The crux of the situation, then, as to whether the consumer will be forced to pay all expenses of production and distribution, is whether or not the product can be taken off the market indefinitely and later on rein-

troduced in instalments. In the case of city lots, it often happens that no matter whether $2,000 or $10,000 was paid for a lot, if the city declines in population, or industries die or leave, the lots, being held by many different persons, must all be placed on the market at the same time if anything whatever is to be received for them; and the intensity of the demand for these lots is the sole determinant of what they will sell for—not what they originally cost the holders. On the other hand, in a rapidly growing city like Detroit, in the year 1914, what lots sold for in certain parts of the city had no relation to cost. Supply was relatively fixed, and demand forced prices far above a figure that would have taken care of original cost and all expenses of advertising and handling. In this case, consumers did not pay a higher price due to expenses of distribution, but they paid a high price because of the nature of the goods with which they had to deal.

Incidence Under Fixed-Supply Distribution.—The incidence of advertising costs on fixed-supply goods is in striking contrast to the ultimate incidence of advertising costs on constant-cost goods. In the latter case, the cost price is known and must as a rule be fully met by the selling price, or distribution will cease. In other words, taking demand for granted, cost determines price. In the case of fixed-supply goods, however, there are many instances where the supply cannot be removed from the market, the exception to this being where the product is controlled by a monopoly. The supply being already in existence, demand determines the price.

If space permitted, many more examples could be given to show that the price of fixed-supply goods may or may not include all expenses (including advertising) incident to their sale. Enough has been said, however, to indicate that goods of this classification are numerous and must be taken into

consideration in any effort to determine the incidence of advertising costs.

5. Distribution Under Joint Costs

Definition of Joint-Cost Goods.—Joint-cost goods are those that of necessity emerge from any productive or distributive process, whether or not the intention exists to produce or distribute these products. Joint-cost goods include not only those produced or distributed because of physical necessity, but also those produced or distributed in an establishment because of custom or usage. Examples of the latter class of goods are certain products like flour, sugar, butter, and eggs, carried by every grocer. From investigations made by the writer (1917-1919) it has been found that practically all grocers are losing money on these four products. By losing money is meant the securing of the original purchase price but only part or none of the overhead properly chargeable to these products. Most grocers would be glad to be relieved of handling these bulky and perishable articles at a loss, but custom demands that grocers supply them and competition enforces this demand.

Goods Produced of Physical Necessity.—Examples are numerous of the class of joint-cost goods produced or distributed because of physical necessity. In recent times, these cases of joint-cost goods have been greatly multiplied by reason of the scientific and industrial development which has made possible the utilization of by-products. An illustration of this occurs in the refining of petroleum, which yields not only common illuminating oil—kerosene—but also vaseline, gasoline, naphtha, and so forth. Again, coal tar, resulting from the distillation of coal for the making of gas, yields a whole line of products, including drugs, perfumes, and a large number of dyes.

In case joint-cost goods emerge from the productive process because of physical necessity, it is difficult, if not impossible, to allocate to each individual product its share of the costs of production which are properly chargeable to it. Moreover, in most cases of this kind the costs cannot accurately be determined. How, then, is the selling price determined?

The answer is that each product will have a price that will equalize supply and demand for that product. This price may be above or below the actual cost of production and distribution of the article, but one thing is certain: the sum of the individual selling prices of the different products must be large enough to meet all of the joint costs of production and distribution. This statement is true, because if all of the costs were not received supply would be cut down, and with demand remaining the same, buyers would necessarily bid the price up to the old figure. This must to some extent be considered a "long-time" point of view, since at any moment of time, for instance between seasons of production, the products are practically fixed in amount and may sell for a price above or below the joint costs of production and distribution, depending entirely upon the intensity of demand.

If goods of this character are advertised, it would seem therefore that advertising costs may or may not be included in the selling price, since this selling price is merely the monetary representation of the value of the goods, as it is believed to exist by consumers in the particular market in which these goods are found. Furthermore, it has been intimated that even where joint-cost goods that emerge from productive and distributive processes because of physical necessity are not fixed in supply, their individual costs are often unknown, and therefore their selling prices may or may not include all the costs of distribution including advertising.

Distribution Because of Custom.—The other class of joint-cost goods emerge from the productive or distributive process because of custom or usage. For example, the retail grocer cannot sell canned goods and vegetables without dealing also in flour, sugar, butter, and eggs. The overhead is known, often exactly, in percentage to gross sales, but this percentage cannot be added to the billed cost of these goods because custom will not permit. Since advertising is one of the expenses included in the overhead, it must be obvious that this cost is not included in the selling price, and hence is not borne by the consumer of these particular articles. The consumer would, however, pay the expenses on these articles should he purchase all of his other groceries at this one store. Then the consumer would be paying a higher price for some articles owing to the fact that he was paying a lower price for others, since the gross income of the store must at least equal the total expense if the business is to remain solvent.

Manufacturing concerns producing and distributing several articles the intensity of demand for which differs, may, and no doubt do, charge against each different percentages of cost and profit. That is, the mark-up on each is different. They are merely making use of the principle applied in the railroad industry of "charging what the traffic will bear." If one product is not able to bear its full production and distribution costs, some other article produced by the same plant must bear more than its quota of expense. Unless the same customer buys both of these articles, he does not necessarily pay all the costs of advertising. He may pay more of these costs, or he may pay less, all depending on what articles he buys.

Lack of Cost Knowledge.—It may further be said that no matter what classification of costs distribution may be under, or in what stage of costs an individual establishment may be producing, if the costs of each product are not

accurately known, it is impossible to decide whether or not the consumer is paying for the advertising on the goods that he buys, since advertising is one of the costs. Unfortunately the costs of production and distribution of individual products are not accurately known in many manufacturing and distributing establishments. In these establishments cost accounting has made little progress and guesswork rules supreme. Many businesses know whether or not they are getting sufficient gross receipts to cover operating expenses and fixed charges, but further than this they do not go.

This lack of cost knowledge is exemplified especially in retail stores. Only a few proprietors take the time to apportion the cost of so much light, heat, rent of floor space, and delivery to each individual article. They merely divide gross sales into the total expenses in order to determine the mark-up. Sometimes even this is not done, or if done it is too low to cover all costs.

Summary.—Consumers of constant-cost goods that are being currently distributed pay for the costs of advertising them, since the advertising increases the costs of distributing these goods. Consumers of increasing-cost goods may or may not pay for advertising these goods, depending entirely on whether or not the marginal manufacturers are making advertising appropriations. If they are not advertising, the consumer of their goods does not pay for the advertising of the other producers; if the marginal manufacturers are advertising, the consumer pays higher prices because of this fact. Consumers of decreasing-cost goods pay for advertising these goods, but in many cases they would pay more if goods of this character were not advertised. Consumers of fixed-supply goods may or may not pay for advertising these goods. If the demand is great, relative to the supply, the consumer will bear the advertising costs; but with a relatively low demand,

the producer or owner of these goods will be forced to bear the advertising costs—unless the goods are owned by a monopoly. Finally, the consumer of joint-cost goods pays for advertising each of them if he purchases all of the products that come from the one productive or distributive process. If, however, he purchases less than all the products, he may or may not pay for the advertising of them, depending entirely on the intensity of the demand relative to the supply of each.

It should be said that the propositions herein maintained are not intended to decide conclusively the incidence of advertising costs. The purpose of this discussion has been fulfilled if it indicates the complexity of the situation, and the care that must be taken in securing concrete data before any generalizations of an authoritative character are made.

The Incidence of Advertising Costs on Well-Known Brands.—As an attempt to secure such concrete data, *Printers' Ink* a few years ago sent a questionnaire to a number of leading manufacturers of branded merchandise. In this questionnaire the manufacturers were asked:[1]

> Can you give us some definite figures proving that since you began advertising one of three things is true: (1) Prices of your goods have been reduced as a result of the larger output secured through advertising. (2) Quality or intrinsic value of goods has been increased. (3) If neither proposition can be proven, can you show that price and quality have remained stable in face of increased cost of raw material and workmanship?

The following are miscellaneous excerpts from some of the replies received:

DIOXOGEN

In the case of Dioxogen, some two or three years ago, reduced costs of manufacture, due to larger production, induced us to increase

[1] *Printers' Ink*, January 22, 1914, p. 3.

the size of our package $33^1/_3$ per cent each on two sizes, and 25 per cent on the third size, without any change of prices whatever, either to jobber, retailer or consumer.

Hart, Shaffner and Marx Clothes

Volume alone would have enabled us to decrease the cost of the goods; but advertising has undoubtedly decreased also the cost of selling. It costs to sell our goods only half as much as it cost fifteen years ago; we figure the advertising as part of the cost of selling.

Kodaks

Largely increased output means economies in every direction, but especially in the matter of automatic machinery, which makes it possible to turn out uniform goods at greatly reduced costs. It means a reduction in overhead expenses that more than offsets the advertising expense, which is, of course, a part of such overhead.[2]

Mallory Hats

Since starting to advertise in 1906, our sales have increased 270 per cent. This increased demand for Mallory hats which our advertising has created enables us to run our factory on full time the year round, making a great reduction in overhead charges. Formerly, in common with all manufacturers of unadvertised hats, we were able to run to full capacity just during the two hat-buying seasons of the year, with a long, dull period between each season.

Since starting to advertise in 1906 we have made a saving of 17 per cent in the total cost of selling Mallory hats. This saving, which amounts to 7 cents on every hat we manufacture, more than pays our advertising appropriation. The savings in selling expenses has largely been brought about through the increased demand for Mallory hats which our advertising has created, with little or no increased traveling expenses. Formerly our salesmen could not interest dealers in every town and city they visited; and now they

[2] Since 1888, the year in which national advertising was commenced, and the year the Kodak was first placed on the market, the $25 camera has fallen to $10, and the $60 one to $20. The retail selling price of the films has not been reduced, but the film itself has been greatly improved and the dealer's margin of profit increased.

sell many dealers in every place visited, and in quantities which are constantly increasing.

This great saving in our manufacturing and selling expense is largely due to advertising, and the consumer is benefited by it because we can now give better values than formerly, even in the face of increased cost of raw material and workmanship.

B & M Fish Flakes

B & M Fish Flakes is the product which we advertise extensively. Our price to the wholesale grocery trade is 25 per cent less today than it was four years ago. Advertising, causing increased sales and naturally increased production, brought about this change.

Underwood's Deviled Ham

The largest increase in our sales, and also the largest increase in our trade discount, has been during the last four years, when we have spent more money for advertising. We feel absolutely confident that had it not been for the inauguration and systematic management of this advertising campaign, our business would be stationary or declining instead of gradually increasing; and that the tremendous cost of selling the product without advertising, combined with increased cost of the product, would have necessitated prices beyond the reach of a large percentage of the present customers.

Holeproof Hosiery

Our prices, both to the trade and to the consumer, are identically the same as they were in 1904, although the cost of raw material and workmanship have increased materially since that time. As a matter of fact, our goods that retail at 25 cents per pair cost us 20 cents per dozen more to produce today than they did in 1905; and it is, of course, due to the fact that we have steadily increased our volume of business by means of advertising that we are able to continue to market these goods at the same price to the consumer.

Kellogg's Toasted Corn Flakes

We can give definite evidence proving both: (1) that prices of our goods have been reduced as a result of the larger output secured through advertising, and (2) that quality and intrinsic value of goods have been increased.

As to No. 1, when our product, then known as Sanitas Toasted

Corn Flakes, was first placed on the market, the package was one-third smaller and sold for 15 cents. With the increased distribution resulting from national advertising, we have increased the size of the package 50 per cent and decreased the price to the consumer $33^1/_3$ per cent; so that the consumer today receives more than twice as much for his money as he did of the unadvertised product.

Williams' Shaving Stick

The consumer is getting 20 per cent more soap in the nickled box with hinged cover today than he got years ago in the plainer and less expensive box. . . . The dealer is buying our shaving stick at 2 per cent less than the former price, he is getting the freight paid on his shipments . . and all this during a period when products in general were going upward in cost.

20-Mule Team Borax

In the case of the "20-Mule Team" Borax, it is true that advertising has reduced the cost to the consumer through an increased output. When borax was comparatively unknown to the average consumer, it was sold principally by druggists, and, being classed as a drug, sold at a rather high price, as high as 30 cents per pound. Today, through extensive advertising, "20-Mule Team" Borax has become familiar to the consuming public, and its many household uses have taken it out of the drug class, and it is now sold largely through grocers as an article of general household utility. The retail price today is 15 cents a pound in one-pound packages, and 10 cents a pound in five-pound packages. . . .

This . . . is a conclusive demonstration of the fact that advertising does not add to the cost of goods to the consumer, but, on the other hand, enables the manufacturer to increase his output; making it possible for him to introduce improved methods in manufacturing, with a consequently improved product, and enables him, even in the face of increased labor costs, to reduce the retail price on his goods to the consumer.

Ingersoll Dollar Watch

We have not revised our prices as a result of advertising, but we have done what is the equivalent; for during twenty years in which there has been a constant rise in nearly all other products

we have kept our prices the same, and have at the same time made more than a dozen improvements of great advantage to the consuming public at considerable cost to ourselves. . . .

Our output has arisen from a few hundred to fifteen thousand per day. Improved manufacturing facilities, inventiveness, and a constantly enlarged field cultivated by advertising, which has kept people informed of our improvements, have permitted us to progress in the manner I have herein described.

WELCH'S GRAPE JUICE

Grape juice, or unfermented wine, as it was first called, was unknown when Dr. Welch put up the first dozen bottles in 1869. There was no demand for the product; most temperance people opposed it, and those who favored fermented wines of course opposed it. The demand had to be created. The public had to be educated —and because of the fact that there was very little money available for advertising and salesmen, the growth was very small during the first twenty or twenty-five years. During the past fifteen years the growth in the popularity of grape juice has been quite rapid—a growth made possible by advertising. . . . Grape juice now sells at one-half what it did in 1897, while the price of grapes has increased from $10 per ton to $40 per ton.

WARNER DOLLAR CORSET

Advertising which has brought increased sales has permitted enormous increases in the intrinsic value of the goods.[3]

JELL-O

Fifteen years ago we spent a few hundred dollars a year advertising Jell-O; now we spend half a million, and all the time the price of Jell-O has remained the same, 10 cents a package, though thousands of dollars have been expended in increasing the quality of our product.

ESKAY'S FOOD

Advertising has built our business from nothing to sales amounting to several hundred thousand dollars per year. With the growth

[3] The total value of labor and materials in a dollar Warner Corset of 1913 was 37 per cent greater than in 1910.

of this business, and by reason of handling larger quantities each year, we were able to reduce the item of labor per package, and in the face of an increase in the cost of raw material continue to give the jobber, the retailer, and the consumer the identical goods, in the same size package and at the same price every day, every month, and every year.

Waterman Fountain Pens

The selling prices to the public of Waterman's Ideal Fountain Pens are substantially the same today as they were at the time of their inception thirty years ago. This in the face of the fact that both labor and component materials of manufacture have nearly doubled in cost, taxes are higher, many items of selling expense are greatly increased, and competition is keener.

. . . . The expense of advertising Waterman Ideals enters into the cost of the pens, the same as taxes and import duties. . . .

The missionary work which must be done on behalf of our company can be handled more cheaply through intelligent advertising than by the employment of salesmen who must be paid a living wage. As this is an important element in the final cost of the product, we do not hesitate to state that the users of our pens would be paying a higher price today if we had not been able to develop our business with the help of judicious advertising.

In the early years of this business all the Waterman Ideals were sold through the direct efforts and solicitation of the inventor and one or two assistants. The time consumed in the sale of each pen often amounted to more in its value than the cost of the complete pen. The business world would never have progressed on such a sales basis unless possibly through an enormous selling organization which could make the output sufficiently large to warrant the minimum of cost, and it is a certainty that the *per se* cost of such a selling organization would have been (and has been found to be) far in excess of the cost of the advertising method of securing distribution and demand.

Munsing Union Suits

If advertising added to the cost of distribution we certainly would not continue to advertise. If values offered were not greater than those to be found in non-advertised goods, the merchant would

certainly not buy in increasing quantities each season, and certainly Munsing Union Suits would not have become the most popular union suits with the public unless they were the most satisfactory.

Indestructo Baggage

We are convinced that were we to discontinue our advertising, our business would fall off at least 50 per cent, which would force us to distribute our overhead over about half the production which we are not getting. This would increase our cost per trunk very much more than the saving per trunk which we would make by discontinuing our advertising would amount to.

Babbitt's Best Soap

In all laundry soaps it can be proved that the large output obtained through advertising has enabled the manufacturer to cut manufacturing and selling costs to the very great advantage of the consumer.[4]

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[4] To substantiate this statement, Babbitt's Best Soap sold for 10 cents a cake forty years ago; now it sells everywhere at six for 25 cents.

CHAPTER XIV

TRADE-MARKS AND UNFAIR COMPETITION

Necessity of Trade-Mark.—When industry was personal, i.e., when the producer sold directly to the consumer, it was unnecessary to identify the goods. The consumer knew the originator of products and could hold him directly responsible for their quality. This close relationship tended to keep manufacturers from debasing their merchandise, since responsibility for its character was fixed. As markets widened, however, and the producer and consumer became strangers to each other, the manufacturer's sense of responsibility for the quality of his goods became dulled, while the consumer had difficulty in running down the origin of his purchase. Substitutes flooded the market, put out not only by competitors but also by the makers of the original product. The consumer had no standard to judge by, and often purchased a brand other than the one he intended to buy. To prevent this confusion, and to build up a permanent trade based on quality, manufacturers have devised trade-marks and trade-names to distinguish their products from those of competitors, thereby assuring the purchaser that they welcome the fixing of responsibility.

Purchasing Goods by Trade-Mark.—The public has responded favorably to the manufacturer's attempt to eliminate the worst evils of the present system of impersonal relationships in industry. Goods are increasingly purchased by name. If an article gives satisfaction, the customer does not desire to experiment with some other brand; he profits by past

experience and again purchases the same article. Experimenting takes time and effort, and the trade-mark saves the customer the need for experiment.

The Three Methods of Marketing.—Goods can be marketed by three different methods:

1. Goods may be sold in bulk. This method is necessary where the customer lacks confidence in the article and desires to inspect it in its entirety before committing himself to a purchase. It is an expensive method, necessitating the use of the goods in convincing the customer. This expense arises not only in the manipulation of heavy articles (pianos) or goods difficult of transport, but likewise in the depreciation in value of certain goods, owing to handling (laces, books, clothing). It is also an awkward method. Goods have to be stored while being inspected and often congest available space and reduce the efficiency of routine work. Such a method is comparable to carrying coins with which to pay bills, rather than using checks, drafts, and bank notes for the purpose. It is usually much easier to transfer the trunk check than the trunk; in the same way it is usually more economical to transfer bills of lading, warehouse receipts, etc., than the goods they represent.

2. Goods may be sold by sample. If the merchandise is of a homogeneous character, selling by sample is easily possible. Thus, a probe injected into a car-load of grain will represent quite accurately the nature of the entire bulk. If, however, one steer is taken from a car-load of steers, it does not necessarily follow that the one selected is typical. In the case of manufactured goods where there is no assurance that the commodity in the sample package is of the same quality as that in the original, a certain amount of customer-confidence must exist in order to market such merchandise by sample. Before a permanent trade based on sample can

result, the original products must in all cases correspond in quality with those in the sample package.

This method of marketing is less expensive and more efficient than marketing in bulk. The sample costs less to transport and handle than the original article, while depreciation on it is smaller than would be the case on a large article of the same quality. It is likewise easier to handle and facilitates quicker sales. Delays do not occur because it cannot be manipulated and brought to function, as is often the case with the larger original product. Notwithstanding these advantages, the sample costs money and there is some expense in handling it. The sample method, however, though often cumbersome and expensive, is an advance in marketing goods.

3. The most advanced marketing method is selling by description. Here the cost is less than in the other two cases, while no difficulty arises in transporting, manipulating, or otherwise exhibiting the goods. The goods are, in fact, not seen by the customer. This method implies a large amount of customer-confidence. The representations must be believed, otherwise the goods will not appear desirable. Very often a long period of square dealing and fair representations must precede any extensive use of the description marketing method. But when this confidence (good-will) is built up, it is hard for competitors to shatter it. It yields increasing dividends.

The Trade-Mark as a Marketing Device.—The trade-mark is a device enabling goods to be sold by description, rather than by sample or by bulk. In so far as it identifies products, it describes them. All the satisfactions, utilities, desirable qualities, and functions which may have been advertised widely in connection with the article, are concentrated in the trade-mark. A glance at a trade-mark should call to the mind of the customer the real significance of the article to him. Perhaps a good deal of copy surrounds the trade-mark, but

it is unnecessary for the reader to wade through all of this if he has already tested the article. He is able to take the quality for granted and purchase without questioning. The representation becomes the thing represented, just as the gold certificate is in reality the gold coin so far as the average citizen is concerned. He knows that the trade-mark is the goods, therefore it appears unnecessary for him to see them. The trade-mark thus aids in marketing goods and benefits the customer as well as the manufacturer.

Functional Classification of Trade-Marks.—Trade-marks may be classified as regards the rôle they play. They may be defensive, offensive, or a combination of both. A defensive trade-mark performs the function of a protector. An illustration of this is "B.V.D." This trade-mark includes no selling element; it merely distinguishes the article so branded from a similar product. It is an identification mark to aid the customer in buying. Such a trade-mark must be easily seen, have distinctive qualities, and be easily remembered.

An offensive trade-mark must be a salesman, in that it must help sell the goods. In one or two words, a single idea appealing to a strong buying motive of the customer is emphasized. If the trade-mark can be offensive and defensive, i.e., play the rôle of both protector and salesman, it is doubly effective. An illustration of such a trade-mark is "Old Dutch Cleanser." It identifies the product and protects it from substitutes, and yet at the same time drives home the idea, "It chases dirt." Another example is "Gold Dust," admonishing the customer "Let the Gold Dust Twins do your work." If a trade-mark with selling ability can be made protective, the result is ideal.

Protecting a Family of Products.—As already indicated, the customer must have great confidence in the manufacturer's

representations in order to purchase goods by means of trade-mark or description. Many manufacturers have spent years in building up customer-confidence, which is nothing but good-will. If each article took such intense cultivation of the market, the expense per product would be high. The costs of marketing a family of products is reduced materially by assembling them all under one trade-mark which has the confidence of the public. In this way the good-will which has been created can be utilized to its fullest extent. Where a single product is put out under a trade-mark which has taken much money to build up, a large part of its utilities go unused. It is to utilize this unused capital that manufacturers sometime conceive of producing a family of products.

An illustration of thus utilizing a trade-mark is the "Beech-Nut" family of products. The cost of securing the confidence of the public for each additional member of this family decreases, and it is to the advantage of the consumer to have this expense of identifying products decrease, since, competition assumed, the ultimate price will be less because cost will be less. If, because of exceptional quality or early pre-emption of the field, competition is inconsequential, the producer of the family of products will earn large dividends on the original investment of the trade-mark advertising. Trade-marks similarly used are: Heinz, Armour, Rubberset, Keen Kutter, and Arrow.

A trade-mark is merely the representation of all the claims a company has made and the extent to which they have been lived up to. In a sense it is a vehicle which conveys to the consumer's mind a summary of the significance of the article to him. Like other vehicles, it can transport more than one occupant or product, and with every additional unit transported, the cost per unit decreases. Such inclusive use of the trade-mark is one of the most economical methods of distributing goods produced on a large scale or in variety.

Former Trade-Mark Law—1. Descriptive Trade-Marks.—During the existence of the trade-mark law, from 1905 to 1920, if the manufacturer desired his trade-mark registered so that duplication would be illegal, certain restrictions or rules had to be observed. The first of these was that the trade-mark should not be descriptive. That is, the trade-mark should not describe the most prominent characteristics or qualities of the goods to which it was attached. This regulation was made in order to prevent confusion, and in practice was as much to the advantage of the manufacturer as it was to the consumer. Thus, for example, if the trade-mark of a fabric were "Non-Shrinkable," and a customer had asked the salesperson whether he had the "non-shrinkable goods," the latter might have replied in the affirmative and produced goods of another brand with the non-shrinkable characteristic. In other words, the difference between a non-shrinkable fabric and the "Non-Shrinkable" fabric might have been vague in the customer's mind, and it was thought that substitution by unscrupulous salespersons would be encouraged if legal countenance were given to any such descriptive trade-mark.

Some manufacturers, however, had faith in the efficacy of the descriptive trade-mark and adopted it, although they were not allowed to register it. They thus ran the risk of the introduction of similar trade-marks by competitors, but assumed that some advantages of the descriptive trade-mark would more than offset this possibility. What these advantages were have not always been clear to the inaugurator of the trade-mark or to others. One supposed advantage was that the memory and interest value of the trade-mark was heightened. This may have been true, but less risky devices existed for securing this end than the descriptive trade-mark.

Trade-Marks Descriptive with Use.—Some trade-marks were not descriptive when the article was introduced on the

market, but became so later. This fact has been true of new articles which temporarily dominated the entire field and the public mind, and whose names became substituted for the articles which they were supposed to represent. Such has been the case of the Victrola. The Victrola dominated the talking-machine field for so long that many people grew to use the word "Victrola" when referring to talking-machines in general. Thus, "Victrola" became a descriptive trade-mark because it meant talking-machine. In order to be descriptive a trade-mark may be made up of words which the dictionary meaning indicates are descriptive, or of words which in colloquial usage have grown to be descriptive. Obviously, a manufacturer cannot be certain whether or not his trade-mark will become descriptive with use.

Many illustrations could be given where substitutions have been effected and misunderstanding produced because the trade-mark grew descriptive with use. Referring again to the Victrola, a farmer came into a department store and said, "Have you Victrolas?" "Yes," said the salesman, "please be seated and I will show you some excellent 'Edison-Victrolas.'" In this case the customer thought of all talking-machines as Victrolas, simply because he had seen the word Victrola and the picture of the talking-machine associated together so continuously. Such confusion has been avoided to a great extent in the case of the Kodak which has come to be identical with the word "camera," by cautioning the public, "If it isn't an Eastman, it isn't a Kodak." Accurate sales by description are thus developed because the customer learns to call for a Kodak only when a certain kind of camera is desired.

The best kind of a trade-mark is one which suggests the use of the article, or its chief characteristic, but does not describe. Such a trade-mark is "Sapolio." The transposition of two letters in this name satisfied the requirements of the old trade-mark law and did not describe the article; yet it

suggests what the article is used for. "Ri-al-fa," a trade-mark for a family of products containing the extract of alfalfa, suggests this ingredient without stating it. When this suggestive feature is embodied in a fanciful name such as those given, the trade-mark is most effective, i.e., distinctive, easily identified, and long remembered.

2. **Exploitation of Geographical Names.**—The second requirement of the old trade-mark law was that the trade-mark should not exploit a geographical name. This regulation, as well as the one previously discussed, was designed to protect both the producer and consumer by making substitution difficult. If several vacuum cleaners are made in Detroit, and one of these is called the "Detroit," the customer asking for "the Detroit vacuum cleaner" might be given any vacuum cleaner manufactured in Detroit. Some customers would no doubt instantly recognize such a crude attempt at substitution, but many others could be induced to purchase the substitute without recognizing it. It was believed that if it were not for this law thousands of articles would be named after the cities in which they were manufactured, and because of similar articles produced in these same cities much opportunity for misunderstanding would result.

3. **Names of Persons.**—The third requirement of the old trade-mark law was that names of living men should not be used without their consent, nor the names of dead presidents of the United States. This prevented manufacturers from appropriating people's characteristics and associating them through the use of their names, with commodities over which these people had no control. Thus, if a hat were named the "Roosevelt," it would take unto itself all of the virile, honest, daring qualities of the man himself, yet Roosevelt would be unable to ascertain whether or not the hat really

had the qualities appropriated from his personality. Again, the name "Edison" on a phonograph associates with the machine itself in the public mind, all the scientific accuracy, remarkable ingenuity and mystic powers of Thomas A. Edison. It was felt that this method of creating value in goods should be carefully guarded by the government; that it should be as closely supervised as the issuance of securities in order to avoid the creation of false values.

When the manufacturer wished to associate personal qualities with commodities, he found it more desirable and less expensive to create an imaginary person and imbue him with the attributes which the manufacturer makes the trade-marked commodity to represent. Thus were created the characters such as Velvet Joe, Sunny Jim, "The man who owns one," and the like. This was perhaps the best policy to pursue for most articles for which special personal qualities were desired.

In looking over advertisements during the last few years, one will see what were apparent violations of the old trade-mark law. Descriptive names such as "Keep Kool," and "Keen Kutter," are in evidence as are also geographical names like "Kalamazoo" and "Waltham." These apparent violations belong to one or the other of the following classes: (1) they were in existence prior to the passage of the trade-mark law of 1905, or (2) they were not registered. Some manufacturers adopted geographical and descriptive trade-marks to identify new products, generally through ignorance of the law, and were loath to change the trade-mark after it had been used in building up good-will.

Alteration of Trade-Mark Law in 1920.—In 1920 the old trade-mark law was altered to permit the registration of descriptive and geographical name trade-marks, because many manufacturers were handicapped owing to the fact that trade-marks legitimately theirs, were imitated. Kitchen Kleanser,

among other trade-marks, lost heavily on account of the old law. Competitors adopted the name because of its non-registerability and secured business rightfully belonging to the original company. Yet it would have been costly to have surrendered this trade-mark to competitors and to have created a new one which was registerable. Of course, the possibility of relief under the common law existed, but many manufacturers hesitated to become involved in long and costly litigation. The only practical course was to create business with the original trade-mark and permit imitating competitors to gain what business they could through the same device. Obviously this was an injustice to the originator of the trade-mark. On the other hand, it seems apparent that the new law will permit certain injustices to be done to the consumer, who will probably become more confused in the identification of products.

Attaching Trade-Marks to Products.—Even if the trade-mark is distinctive and registerable, some difficulty is often experienced in attaching it to the product. This has been the case with bulk drinks. Where bottled drinks are sold, the trade-mark on the label identifies them, but where the liquor comes in bulk and is sold by the glass, its identity disappears. This impediment to identification has been overcome by placing the trade-mark on a receptacle from which the liquor is drawn. It has been held to be illegal to use such a trade-marked receptacle for any drink for which it was not intended. In the case of rope, the trade-mark has consisted of a colored thread which is visible throughout its entire length. In wire netting, the trade-mark has been woven into the border. Paper seemed impossible to trade-mark until the process of water-marking was discovered. This is a good example of the way in which an article may be completely identified or graded by a mark which utilizes no part of the product.

Relation of the Trade-Mark to Good-Will.—Good-will gives permanence to business; without it all business except monopolies would be temporary in character. When customers desire to maintain continuous trade relations with a business establishment, or desire to make continued purchases of a commodity, this intention serves as a stabilizing force which is called good-will. Good-will cannot exist apart from the means of identification—the trade-mark—which enables customers to distinguish between those businesses or commodities which have excited either their friendliness or ill will. To the extent that distinctiveness is modified by similar trade-marks, to that extent is good-will modified, or perhaps nullified. In order to prevent the alienation of good-will from rightful owners, it is obviously necessary for the law to prevent deceptive imitations or duplications of representations of good-will.

Necessity of Trade-Mark Dependent Upon Industry.—Where a monopoly exists there is obviously little need of an identifying mark for the product. It is when competition enters that such a device becomes necessary. The greater the ease with which competition can enter into an industry, the greater the necessity of a trade-mark. Thus, in the case of the knit-goods industry, where one may commence production with little capital—often in the home—it is extremely desirable to protect goods which have merit. It is of little use to create value in goods unless this value can be protected. One of the great losses arising from competitive industry has its origin in loss of commodity value due to substitution.

Trade-Marks and Monopoly.—Since the application of a trade-mark to a commodity does not involve an exclusive right to make or sell that commodity, a trade-mark is not monopolistic. In this respect it differs from a patent or copyright.

The latter are profitable because they carry the right to exclude imitations. Good-will represented by a trade-mark, however, induces the customer to purchase a particular manufacturer's commodity in preference to a similar commodity made by someone else. It implies choice, not compulsion, between competing commodities. Patents and copyrights exclude competition; trade-marks are based upon it. Competition without trade-marks would result in confusion for the consumer, while monopoly without trade-marks would lead to no such result.

Though trade-marks are not monopolies they serve as hindrances to perfect competition in so far as they produce buying habits, i.e., the tendency of consumers to buy as they have bought before, or to buy as others do. It is always easier to do what one has done before than what one has never done before. Because of this natural force of habit which modifies the actions of all people, a trade-mark limits the working of the force of competition if it succeeds in inducing customers to make repeated purchases of a commodity. Even when competing commodities of a similar kind are better than the trade-marked article, it may be possible for the trade-marked commodity to hold its customers for a longer time than its relative merits would warrant. Because the trade-mark is the sole means by which a buying habit is developed and perpetuated, it is an asset frequently of more value than the machinery which makes the product physically possible.

Effects of Competition Upon Trade-Marks. — Because people persist in buying what they are accustomed to buy, a habit which trade-marks, trade-names, and distinctive packages make more easy to form, good-will has more than a temporary value. Manufacturers and merchants will not wish to see the public form the habit of buying a competitor's

goods, for the stronger the habit becomes the harder it will be for them to break into the market. Strong efforts will be made to divert customers from the habitual use of any brand. In fact, it may be laid down as a rule that the amount of competition that a new trade-marked article will provoke varies directly with the success it has in developing buying habits for itself. If the new commodity obtains an apparent monopoly of the customer's attention and money, such a situation will almost automatically cease to exist as soon as competing brands appear on the market. Often this competition to share in the good-will which the public holds toward a commodity becomes so vigorous that the rights of trade-mark owners and consumers are transgressed. Such competition is usually termed "unfair competition."

Unfair Competition.—Unfair competition is the attempt to represent one man's goods as those of another. It is deception. It attempts to divert trade from one branded article to another by making it difficult for customers to identify the original. It is successful in so far as it is possible to imitate trade-marks, labels, packages, and trade-names. The law therefore prohibits, by means of injunction, the use of any trade-mark, label, package, or trade-name which would confuse the average customer and lead him to purchase a brand other than the one he supposed he was purchasing. The "average customer" is the ordinary customer who is careless and indifferent in his purchasing—the man or woman who does not take constant precaution against deception. The customer who uses intelligent discrimination between trade-marks, trade-names, labels, and packages is the exception.

That the average customer is unwary and only infrequently examines with care commodities offered to him, makes possible predatory competition. It has been ascertained from tests that nine out of ten customers do not know who makes

the goods, where they are made, or the points of distinction in the goods themselves and pay little attention to the information given on the containers. This was illustrated forcibly in a case for infringement brought by Walter Baker and Company, Ltd., of Dorchester, Mass., against W. H. Baker and Company of Philadelphia and New York. In this case it developed that although the former company had advertised and sold its chocolate and cocoa for over a century, housewives were calling for Baker's chocolate and did not know whether these products were manufactured by Walter Baker, W. H. Baker, William Baker, or some other Baker. Neither did they know where these products were made, nor the distinguishing features of the labels and packages. These products were designated to a large extent, by reference to the illustrations on the labels, as follows: "the chocolate with the lady;" "the chocolate with the Quaker lady;" "the chocolate with the Dutch girl on the back;" "the chocolate with the yellow label and a German lady on the wrapper;" "the chocolate with the woman on it;" "the chocolate that has the picture with the tray and cups;" "the chocolate with the picture in Colonial costume;" and so forth.[1] Because of such vagueness in remembering names of manufacturers and points of distinction on labels and packages, courts have not hesitated in most cases to grant relief to owners of branded commodities when it has been shown that the ordinary customer has been misled; even though there might be enough points of dissimilarity between the packages, trade-marks, labels, and trade-names to enable a careful buyer to make an intelligent distinction.

Kinds of Infringement.—Infringement may take several different forms:

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[1] E. S. Rogers, Good Will, Trade-Marks and Unfair Trading, p. 68, Chicago, A. W. Shaw Co., 1914.

1. Deceptive names.
2. Imitation of color and appearance of labels and packages.
3. Imitation of the form of the package or the article.
4. Appropriating dissimilar designations which nevertheless cause commodities to be known on the same market by the same name.
5. Refilling genuine packages with counterfeit goods.
6. Substitution.

They are all alike in one respect, however; they are means of representing one maker's goods as the goods of another. They will serve to make identification difficult and handicap the customer in carrying out his intentions, while at the same time they appropriate the property of good-will which the maker has succeeded in building up.

Deceptive Names.—The following trade-names have been held to infringe irrespective of their surroundings:[2]

Apollinaris	Apollinis	Gold Dust	Gold Drop
Bovina	Boviline	Keep Clean	Sta-Kleen
Cascarets	Castorets	Muralo	Murrilo
Celluloid	Cellonite	Rising Sun Stove Polish	Rising Moon Stove Polish
Ceresota	Cressota	Royal Baking Powder	Royalty Baking Powder
Ceresota	Certosa	Sapolio	Sapia
Cocoaine	Cocoine	Sapolio	Saponit
Cocoatina	Cacoatine	Sapolio	Sapho
Cottoline	Cottoleo	Sapolio	Sapono
Creamalt	Crown Malt	Sorosis	Sartoris
Cuticura	Curative	Tonge's	Tung's
Cuticura	Cutis-Cure	Uneeda	Iwanta
Cuticura	Curato	Wamsutta	Wamyesta
El Destino	El Devino	White Rock	High Rock
El Destino	El Destinacion	Yusea	U. C. A.

[2] E. S. Rogers, Good Will, Trade-Marks and Unfair Trading, p. 143.

Imitation of Color and Appearance of Label and Packages.—One of the well-known cases of such infringement is that of the Uneeda Biscuit. This trade-name was infringed by the name "Iwanta," but further than this, the appearance of the package and the color of the label on the end of the package were similar. Not only was the label of the same color, i.e., red, but it was of the same shade of red. The design on the infringing label was nearly identical and on it appeared the words "Factory Seal," while on the Uneeda appeared the words, "Inner Seal." The Gold Dust package has been held to be infringed by the Buffalo Soap Powder, since the packages are the same size, color, and general appearance. The Paris Garter has been held to be infringed by the French Garter because of the general imitative get-up and approximation of catch phrases. For example, the Paris Garter trade-mark says, "No metal can touch you;" the French Garter trade-mark says, "No metal touches you." Likewise, the former brand says, "For year-round wear," while the latter brand says, "Best for all-year wear." The manufacturer of a certain brand of absorbent cotton, on the container of which was the picture of a red cross, enjoined the manufacturer of another brand from using the same designation even though he used a differently shaped label, box, and design.

Imitation of the Form of Package or Article.—If it is difficult to attach labels, or if it is impossible to keep them attached, imitation may take the form of deceiving through the shape of the containers or product. For example, the Charles E. Hires Company has had difficulty in securing identification for its carbonated root beer because the bottles come into contact with the ice so that the labels are easily washed off. In order to remedy this difficulty and secure adequate identification for its product, this company devised a distinc-

tive cylindrical bottle with high shoulders and a short neck. The Consumers Company of Chicago adopted the same shaped bottle for marketing its root beer, although its other beverages were sold in bottles of different shape. The Consumers Company was enjoined from using the same shaped bottle as the Hires Company.[3]

The form of an article, when it has been a prominent means of securing identification, has likewise been protected by the courts from imitation. For example, it has been held that Cascarets were infringed by a competitor who put on the market a similar tablet, cast in an octagonal form. Relief was secured by the Yale and Towne Company from a competitor who made a padlock the same shape as the Yale lock. A manufacturer of an oval-shaped loaf of bread succeeded in enjoining a competitor from imitating this shape. It has been held that the imitation of the architecture of a store front was unfair. The Coca-Cola Company secured an injunction against the manufacture of a beverage which was artificially and unnecessarily colored to resemble Coca-Cola. In all of these cases the courts have endeavored to protect identification devices, so as to lessen confusion on the part of the buying public, and to protect the property right of good-will which has been built up as a result of extensive and costly advertising.[4]

Deceptive Designations.—Reference has already been made to Baker's Chocolate which was widely known to customers by the "lady." The Puritan Pure Food Company manufactured a chocolate with the picture of a lady on the label of the box. Notwithstanding the fact that this picture was dissimilar to the picture of the lady used on the Baker

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[3] E. S. Rogers, Good Will, Trade-Marks and Unfair Trading, p. 197.
[4] *Ibid.*, pp. 200-201.

label, the court ruled that it would not be fair to permit the Puritan Company to use this designation, since its product might become known as the "chocolate with the lady" and thus become confused with the product of the Baker Company. In another case, a haberdasher was enjoined from marking his shirts with a star because they might become known as "Star Shirts," a designation by which a certain manufacturer's shirts were known. In this instance, the infringing mark was dissimilar in shape and color. Similarity or dissimilarity of trade-marks, trade-names, labels, and containers are not the important considerations in a case of infringement, but rather whether such designations cause products to be known on the same market by the same name. The effect of such designations is scrutinized more carefully by the courts than the designations themselves.

Refilling Genuine Packages with Counterfeit Goods.—A common method of unfair trading which seeks to prevent identification, and one difficult to detect, is the refilling of genuine containers with other than the original product. Lea and Perrin's Sauce, Pinaud's Hair Tonic, Horlick's Malted Milk, Hires Root Beer, and other well-known products are constantly being infringed upon in this insidious manner. Fraud of this nature may entail serious consequences because users of the genuine article may detect a deterioration in quality and discontinue their use of it. Thus the manufacturer loses distribution for his product by reason of an unseen force, which, because of its intangibility, is difficult to combat.

Substitution.—To sell a substitute article when a specific brand has been asked for is false representation similar to that described in the previous paragraph. In the one case a representation was made that the merchandise contained in the package was genuine; in the other case the same repre-

sentation is made without the use of the genuine package. When a customer asks for Old Dutch Cleanser he is entitled to get it. If the dealer gives him something else without comment he is acting unlawfully and can be enjoined from making such proffers. The customer is entitled to receive the goods he asks for.

Identification Devices as Marketing Machinery.—Identification devices and the advertising which exploits them are a part of the machinery of marketing, and like other machinery they are efficient only when they function as intended. Imitation, in all of its subtle ways, handicaps proper functioning and is therefore rightfully restrained by the courts. Representing one's goods as the goods of another is only one way of securing someone else's property without a just consideration; and in all ages has been held to be illegal. If permitted, it would result in the return of *caveat emptor,* with its consequent slowing up in the speed of sales and an increased cost of marketing. Any device which permits purchase by description, and ready identification, increases the speed with which sales are made and results in lowering marketing costs.

CHAPTER XV

PRICE DETERMINATION

Maintaining Profitable Distribution.—The way in which the manufacturer is making a fight to gain distribution has already been indicated. After he has gained his distribution he must maintain it. Unless this is done, the selling costs per unit increase as the number of units of goods sold decreases. This means either raising selling price to cover the higher costs, or keeping the old selling price and taking the higher costs out of profits. The latter method is impracticable for any length of time, for with all lure of profits gone there remains no incentive to continue producing goods. The former method likewise cannot be successfully carried out in many cases, because of competitors' prices or because custom has made price habits. Thus it is seen that above everything else the manufacturer must maintain and if possible increase his distribution.

Effect of Price-Cutting on Distribution.—When a retailer in a small town in central Illinois cuts the price of a nationally advertised article, it may seem of little importance to the manufacturer. This act may, however, make the small leak in the dam which, if it is allowed to continue, may endanger the whole structure of distribution. Jobbers and agents of competing manufacturers' goods spread the news to their clients in other parts of the country, and soon there may be an aversion on the part of many merchants to handling this particular article. So even before a large city department store cuts the price of an article, other merchants in

that city might decline to purchase it. It is enough for them to see price tendencies in other parts of the country. If the manufacturer does not prevent price-cutting in one part of the country, he will probably not attempt it in another. The average merchant desires a product which he can handle permanently; he is suspicious of goods which absorb his good-will only to be discarded because of their unprofitability due to competitors' price-cutting.

Arriving at a "Right Price."—Since distribution must be maintained at all costs and because price materially affects distribution, the question of fixing a "right" or "fair" price is important. The retailer must be allowed to charge a price which insures him a fair profit, otherwise he will not handle the goods; or, if he does handle them, he will not push them. Cases have been known in which the main defect in the manufacturer's distribution scheme was too low a margin of profit to the retailer. The retailer as well as the manufacturer must have something to work for. On the other hand, too long a margin of profit tempts the retailer to price-cutting because he feels that he can make a satisfactory profit on a lower selling price.

The difficulties in arriving at a right price are further aggravated because the right price to one dealer may be the wrong price to another. Because of a quick-turnover merchandising policy, an article with a low margin of profit may appear attractive to some stores, if a consumer-demand has been created; while from the standpoint of other stores with different merchandising methods, the profit-producing possibilities of this particular article may appear negligible. All the manufacturer can hope to do is to fulfil the profit expectations of the average merchant who is in a position to handle his goods.

The right price from the standpoint of the average mer-

chant, may often be reached only through the process of experimentation. Like all knowledge gained through experience, it is costly. The results of cumulative memory and good-will in regard to the price of a commodity are lost when its price is changed, and the more frequently that commodity's characteristics are altered the less stable does it appear in the customer's mind. If, however, the wrong price has been attached to the merchandise, it is far better to change it as soon as its defectiveness is known than to continue with a handicap. A better method of ascertaining the right price is to make a study of all conditions surrounding the article before its price is fixed. Later on, when this price is given to the merchandise it may be found too low or too high, but the adjustment that will have to be made by both the retailer and the customer will be much smaller than where experimentation was more blindly followed.

Attitude of Small Retailer Toward Fixed Prices.—The small retailer looks favorably upon fixed-price goods because they assure him a profit on each sale. With the recent rapid growth of the large store, and the advantage it enjoys of buying in quantity, the small retailer has been forced to face a competition which in many cases has all but put him out of business. As a weapon against this new competition he has grasped at price maintenance on nationally advertised goods for which a consumer-demand has been created.

The manufacturer has been quick to respond to the needs of the small dealer, because his distribution through the large stores was endangered, since large stores insisted on cutting prices or pursued the policy of handling private brands. Demonstrators have been sent to convince the customers of the small store that the quality of the nationally advertised product is better than that of similar lower priced goods. Advertising has been paid for by the manufacturer and placed

in local papers under the dealer's name, while window displays and interior advertising effects have tended definitely to relate the dealer with the manufacturer's national campaign.

Attitude of Large Retailer Toward Fixed Prices.—Naturally, the large dealer is unsympathetic toward the efforts of manufacturers to maintain the prices on their products. He feels that the accomplishment of price maintainence would place him on an equal footing with the small dealer, and his entire effort has been to secure advantages to himself that the small dealer does not have and cannot get. If price maintenance became a reality, his advantage of quantity purchases would be partly neutralized.

Because of this feeling, the large store cuts the price on nationally advertised goods whenever it can use this method to stimulate the sale of other products. Often it is difficult for these stores to get goods direct from the manufacturer or the manufacturer's jobber; but there are devious ways of getting the merchandise without the manufacturer's consent, so that stores such as R. H. Macy and Company continually offer for sale nationally advertised goods below the price at which they are sold elsewhere.

After selling the nationally advertised article for a time and benefiting from the manufacturer-created consumer-demand, the large retailer very often finds that by means of clever salesmanship he can substitute his own brand for that of the manufacturer and maintain his former turnover. Since the private brand is not advertised and therefore carries a larger margin of profit, more profit is made on each turn of the stock, resulting in a materially larger net profit. The lure of this larger net profit is constantly inducing large stores to discontinue nationally advertised products when it is felt that a substitution, carrying a larger margin of profit, can be effected without endangering turnover.

As already stated, this development is drawing the manufacturer of standard articles more and more toward the small dealer, and is stimulating him to help develop the latter's trading possibilities. This close association, stimulated by the necessity of self-preservation, is meaning much to the small dealers. They are realizing their opportunities as never before, and in turn are making much better customers for the manufacturer. Some of the methods adopted by manufacturers in cultivating intensively the smaller dealers are taken up in Chapters II and X.

Arguments Against Price Maintenance.—Some of the arguments against price maintenance may be set forth as follows:

1. Price maintenance does away with competition by preventing competitors from underselling each other. The customer loses the protection of competition as a force which insures him the most for his money; he is at the mercy of a combination of distributors and producers. The price that is fixed may be fair or unfair, but if it is the latter it may be maintained, while under free competition it would be displaced by one which more nearly represented the value of the merchandise. A permanence is thus given to price factors, while the value underlying them is constantly changing.

2. It prevents dealers from sharing efficiencies with customers. Each store is seeking to institute certain internal economies which will lower the selling cost. Examples of these are: quicker turnover, better advertising, more advantageous arrangement of fixtures, less credit losses, adequate accounts, and scientific salesmanship. Under usual competitive conditions, each merchant making use of these economies would for a time enjoy the profits resulting from them, but would be compelled eventually to share them with the consumer. Under price maintenance, dealers would keep these

profits for awhile, but they would sooner or later be absorbed by the manufacturer who would be in a position to cut down the margin of profit as the retailer's net profit from the sales of these products increased. Thus, in the long run, the retailer would be no better off, while the consumer would have suffered a distinct loss. The manufacturer is the only one to gain by such a policy.

3. Price maintenance is a bait held out by the manufacturer to induce retailers to push his goods. Retailers will not do this unless the goods compare favorably with those of competing manufacturers, and to accomplish this end the manufacturer attaches the idea of a certain profit to the goods. Thus the consumer pays for making the goods appear attractive to the retailer. This element of attractiveness or value may exist for the retailer, but it does not exist for the customer. In other words, the customer who purchases a price-maintained article helps to raise the price of the article above its true value. He pays for something which he does not get; either the retailer or the manufacturer gets what the customer pays for.

4. The process of maintaining prices is price boosting—merely extorting the consumer's surplus. Because of the artificial condition created, the customer is forced to pay as much for goods when they are plentiful as when they are scarce. The normal saving or surplus which would accrue to the consumer on each article, were the laws of supply and demand free to operate, goes first to the retailer and eventually to the manufacturer. Goods are thus made to cost more, aggravating the already high cost of living.

Arguments for Price Maintenance.—In contrast with the foregoing, the following arguments in favor of maintaining prices may be noted:

1. Price maintenance does not do away with competition;

it merely makes prices uniform. Competition may force a new lower price level, but when this level is reached, there is competition between dealers who are now selling at a lower but uniform price. In other words, price maintenance merely establishes a plane of competition which may be above or below the old level so far as price is concerned.

2. Price-cutting introduces cheaper substitutes. The customer, being inexpert in judging the merits of merchandise, takes for granted that he is receiving at all times the same article under the same trade-mark. Because of price-cutting, however, the retailer receives a decreasing profit, so that the manufacturer has to keep increasing the attractiveness of his offer in order to make sure that the retailer will purchase his goods. Because he receives less for the merchandise, the manufacturer can put less into them, so that although the goods go under the same name and are sold in the same package, they are, in fact, different or substitute goods. Thus, the quality of merchandise suffers and the customer gets no more for his money than he did when prices of goods were higher. Since the customer cannot permanently benefit by price-cutting, price maintenance is to his advantage because it insures that the quality of nationally advertised goods will be maintained.

3. Price maintenance, while retarding competition along the lines of price, stimulates competition along the lines of service. One merchant endeavors to attract customers from another merchant by giving fairer treatment, providing better merchandising facilities, taking back goods that do not give satisfaction, and in other ways elevating the relationships between buyer and seller. This competition among dealers to provide a complexity of satisfactions is believed to be more desirable for consumers than a competition based purely on price. In a subsistence economy the latter kind of competition seemed necessary, but as standards of living rise and the

luxuries of the few become the comforts of the many, a broader idea of what constitutes customer-satisfactions necessitates a change in the character of dealer competition.

4. A fixed price prevents exorbitant profits. The customer is protected against the unscrupulous dealer who capitalizes customer-ignorance. The customer pays for being relieved of this risk incident to buying, but such a relief is no different here than in any other field. If one wishes to be relieved from the risk of death, fire, or other contingencies, he must pay for it. The customer might in some cases pay lower prices if there were no price maintenance, but there seems to be little doubt that in some cases he would pay higher prices. It is believed that the assurance of a just price is a valuable commodity for which the customer is willing to pay.

Price Maintenance from Standpoint of Public Policy.— With all due respect for the arguments in favor of price maintenance it must be said that, from the standpoint of public policy, it is dangerous:

1. Competition would be eliminated as regards price, and price is the most important element in the sale with a great many people. To make service the important factor as compared with price is to make a readjustment of values, in the making of which the customer has nothing to say. If the customer could be heard, there is little doubt that in many instances necessity would indicate the desirability of competition as regards price instead of competition as regards service.

2. It is extremely doubtful whether price maintenance maintains quality. Advertised goods are no better in quality than it is imperative they should be in order to make them pay. Instead of allowing price maintenance to dictate quality, competition makes quality what it is. Under a system of price-cutting, there are high and low quality goods for the

same price. That is, there is not only competition as regards price but also as regards quality. The same applies to service. Competition of price cannot exist alone; it is inseparably connected with the other characteristics of the goods among which are quality, adaptibility to needs, conditions under which goods are sold (service), and delivery.

3. Price maintenance may very possibly create conditions which discourage competition between manufacturers. This would enable the manufacturer to secure a virtual monopoly of the goods under his control. It may be supposed by some that there would still be competition between the brands of different specialty manufacturers, and there is nothing inherent in a price maintenance policy which prevents such competition. To place the price-fixing responsibility in the hands of the manufacturer, however, would provide an ever-present motive for combination and agreement, and furthermore would simplify the attainment of agreement on price. An informal oral agreement between a half dozen large manufacturers might result in the extraction of the consumer's surplus for a long period of time, as well as producing conditions of monopolistic control in the field of distribution such as have characterized the fields of production and transportation during the last generation—a condition which has called forth all of the corrective powers the state and federal government could employ.

Solution of the Problem.—There is no doubt that unlimited price-cutting endangers manufacturers' distribution and thereby works a hardship on the creators of branded goods. Under such conditions, the advantage is obviously with the large retailer. It is no less evident that unlimited price maintenance places the efficient retailer at a disadvantage in competition with other retailers, as well as endangering the interests of the consumer. Either policy is undesirable be-

cause of the absolute power which it gives to one party. Possibly a combination of both policies may secure justice to the three parties to the selling transaction, viz., the manufacturer, the retailer, and the customer.

It has been proposed [1] that this may be accomplished by instituting, as a new basis for price-making, the principles of a fair profit for every merchant selling a branded commodity. Heretofore the manufacturer has followed the principle of a fair price, which was supposed to give a fair profit to the average merchant. Since the merchants above the average had a lower selling expense, they could afford to sell the branded commodity below the "fair price" and still make a fair profit; while the merchants below the average, who had a higher selling expense, could not make a fair profit by selling the branded commodity at the so-called fair price. Price-cutting is inherent in such a system because the more efficient merchants with the lowest operating expenses can extend their trade only by sharing their efficiencies with the public, and such intention may be most evident when a cut appears in the price of branded commodities.

This kind of price-cutting is also inherent in the proposed plan mentioned above. It is possible that price-cutting can be accomplished by some dealers as part of a continued policy to share economies with customers, without sacrificing a reasonable profit on the commodities whose prices are cut. If this is done as an open and well-recognized policy, it is thought that no harm to the parties concerned can result. The kind of price-cutting which is not inherent in the plan proposed, but which is apparently inseparable from the present system of fixing prices of branded commodities, is predatory price-cutting. The latter species of price-cutting uses branded commodities as loss-leaders to convey an impression to customers

[1] C. T. Murchison, Resale Price Maintenance, Columbia University, Studies in History, Economics, and Public Law, Vol. 82, No. 2, New York, Longmans, Green & Co., 1919.

which often does not exist, viz., that a store is selling all commodities at a lower price than competitors.

An attempt is thus made by this plan to distinguish between legitimate and illegitimate price-cutting. The former is thought to be desirable because it takes into consideration the welfare of the customer and does not injure either the retailer or the manufacturer. The latter is open to condemnation because it preys upon those who have involved large sums in creating value and good-will for branded commodities; because it seeks to deceive customers; and because it places at a disadvantage small retailers who have no private-brand incentive to cut standard-brand commodities.

Difficulties Involved in Proposed Solution.—What is a fair profit? How can it be ascertained? How may the legitimate price-cutter be distinguished from the predatory price-cutter? These and many other questions arise concerning the practicability of the proposal. As regards the definition of a fair profit, the ground has already been broken in other fields. Commissions working in conjunction with technical experts and the courts have laid down some preliminary principles as to what constitutes a fair price which public utilities may charge, and such a price is based on the determination of what constitutes a fair profit as well as other factors.

As regards the ascertainment of a fair profit it would be necessary to develop a standard system of cost accounting for retail stores. A step in the direction of standardized operating expense systems for some classes of retailers has already been taken by the Graduate School of Business Administration of Harvard University. Several hundred grocers, shoe dealers, and other retailers are keeping similar expense accounts, so that the data received from these stores admit of comparison. It would no doubt be possible to standardize present retail accounting methods so that it would

be possible for investigators not only to determine whether a fair profit has been made, but also to distinguish between the legitimate and the predatory price-cutter.

That many difficulties would be encountered in the establishment of standardized cost systems goes without saying. Operating expenses would have to be kept by departments, an unheard of procedure in the small store. It would be necessary to allocate expenses to each department as regards light, heat, floor space, accessibility, turnover, advertising, window display, and so forth. Much difference of opinion exists between expert accountants as to proper allocation of such expenses, and even if it were satisfactorily attained, changes would frequently have to be made to meet changing conditions of handling, change in nature of demand, diverting of trade by reason of new routes of travel external to the store, alterations within the store, and other changing factors.

Fair Prices and Fair Profits.—It has been presumed in forming the proposed plan of price determination, that price-cutting of a trade-marked article is not desirable if the cut price does not include a profit. The question naturally arises whether this presumption is justified. In retail groceries from 40 to 60 per cent of the gross sales consist of flour, sugar, butter, and eggs. Almost invariably these commodities fail to return any profit whatsoever on their sale. There are some who feel that failure to secure a profit on these commodities makes their selling prices unfair. From this point of view failure to secure a fair profit on one-half of the gross sales, necessitates the securing of an "unfair profit" on the other half of the gross sales. If price-cutting were not permitted on trade-marked flour, sugar, butter, and eggs until they bore their proportion of the net profits charge, they would sell at a higher price than at the present time; while the stimulation of competitive price-cutting on canned goods and other articles

which bore more than their proportion of the net profits charge would tend to reduce the price of these latter commodities.

Prices Based on Cost and Value.—In the field of transportation each commodity does not bear all of the costs incident to its transportation. Bulky commodities, such as coal, building-stone, lumber, grain, and so forth, are carried at a rate which does not cover the costs involved. Freight rates on bulky raw material, therefore, may not be considered "fair" by some because they do not include a fair profit. On the other hand, finished products of smaller bulk are moved at a rate which more than covers the primary and secondary costs plus a profit higher than a fair profit, hence it may be considered that they are transported at an "unfair rate."

A situation similar to that existing in transportation is found in postage rates. First-class postage more than covers the costs of carrying first-class mail, while the other classes of mail are carried at a loss. Schools are for the most part run at a loss which is made up from endowments or taxation. Municipally owned utilities often sell their products at a price which does not cover primary and secondary costs, to say nothing of a profit; but this is made up by means of taxation. In this case, taxpayers are forced to reduce the consumption of other goods which they might have consumed had taxes to cover utilities' deficits not been levied. Their consumption of the utilities' products, however, is increased because of the low price. In all such cases, prices are determined, not by cost alone, but by cost and value. The latter element is sometimes known as "what the traffic will bear"; it sets the upward limit to price. Primary costs set the lower limit.

Price as a Directive of Consumption.—As regards schools, postage rates, transportation rates and some public works, it

is thought socially expedient to fix prices which are other than those based on cost. Price is a directive agency; it directs consumption. A lower price on a commodity usually directs people to consume more of it; a higher price directs people to decrease their consumption of it. Competition determines price, with the exception of natural or governmental monopolistic goods, and price determines the nature and extent of consumption. If competition places emphasis on the wrong price-making elements, a wrong or "unfair" price is produced, i.e., a price which directs wealth in channels which are considered socially inexpedient. Hence price-fixing has for its purpose a redirection of wealth and productive effort, very different from that which would be the result of free competition.

Since price directs consumption (and hence production), great care should be exercised in altering it. If it is politically desirable that coal should be transported to districts where no fuel of this nature exists, in order to build up manufacturing industries which would otherwise be at a serious disadvantage with those in more favored districts, it may be necessary to construct transportation rates which will not cover the costs of this marketing function. Or, if homes are considered socially desirable in parts of a country devoid of inexpensive building material, it may be for the public welfare to carry building material to such localities at less than the costs of transportation. A greater number of educated citizens will be found in any country where the price charged for an education is below all the costs connected with producing such an education, than where it is equal to or above these costs. A sale price for a commodity which does not include a fair profit directs demand toward such a commodity. Where society benefits by such a direction of demand, the policy is justifiable; where the benefits to society are unobservable or doubtful, a free and unrestrained direction of

demand is desirable. Hence an unfair price is not a price which does not contain a fair profit, but a price which misdirects demand or wealth. A fair price directs the flow of wealth in directions which are socially desirable.

Determining Retail Prices.—Retail prices are not fixed by governmental authority, as are transportation rates, postage rates, education fees, and so forth; they are determined by the forces of competition. If, then, competitive prices in some cases do not include within themselves a fair profit, and in other cases include more than a fair profit, what conclusion should be drawn? Is the price which has resulted from competitive forces a "right" one in the sense that it is efficiently directing demand? Custom has apparently dictated the policy of lowering the prices of flour, sugar, butter, and eggs, and raising the prices of canned goods and other groceries. Is it desirable for society to have stimulated consumption of these four commodities, or should each commodity in a retail store "pay its own way"?

These articles cannot be considered loss-leaders because they comprise on the average at least half of the total gross sales. Custom has dictated this policy and competition enforces the mandates of custom. Although there is no statute to enforce the fixing of a profitless price on these commodities, nevertheless such a price is dictated by a force as powerful and as exacting as law. Competition through the medium of price is directing the flow of wealth, yet notwithstanding the fact that this is apparently a natural situation, the student of marketing should scrutinize carefully the direction this stream of wealth is taking with the purpose in mind of analyzing the alternative possibilities of different price levels. If the stream of demand is going in a direction socially desirable, the price directing this flow is a "right" one.

Some commodities have standard mark-ups which include

a net profit as well as the costs of doing business. These are usually called medium- and low-priced goods. In merchandise, especially in ready-to-wear clothing, price is often fixed by what merchants call "eye-value," i.e., what it is believed the goods will bring. This price is changed from time to time to adapt itself to any miscalculations which are inherent in any such forecast of customers' estimates of value. Demand, therefore, is the chief factor in determining the price of high-grade goods. Demand and supply have more equal importance in determining the price of medium-priced goods, while the price of low-priced merchandise is influenced largely by supply or cost. It should be noted that while demand is emphasized as the price scale goes up, and supply as the price scale descends, the opposite term of the price equation in each case is assumed; but it is more inert and is not the actively operating price factor.

Price Determination of Fixed Supply Goods.—Merchandise is fixed in supply when its supply cannot be increased or decreased or when such increase or decrease cannot occur at the same rate as demand increases or decreases. An example of goods absolutely fixed in supply is offered by seasonable merchandise such as furs. During a late and mild winter the supply of furs cannot be cut down and it is not desirable to run the risk of carrying them over until the next season. What will determine the price of these furs? The answer is, demand. What the buying public will give for the furs is a more important price factor than what the furs cost. Style goods, obsolescent merchandise, articles which the manufacturer has discontinued manufacturing, and rare, imported commodities, are good examples of merchandise absolutely fixed in supply. "Eye-value" fixes their price, and this price may be above or below the cost of distribution. Whether above or below cost, this price is a "right" or "fair" price

if it directs demand in the direction which is for the greatest social welfare.

Conditions under which the supply of goods was relatively fixed existed for the most part throughout the period of the Great War. Merchandise was being received by merchants in greater quantities, but it seemed as if it was absorbed as rapidly as it arrived. This was true of automobiles, silk shirts, ready-to-wear apparel, shoes, luxuries, and other goods. Many merchants fixed prices for such merchandise at a point which would move the goods, i.e., prices representing "what the traffic would bear." Such prices were not based on cost, but on the absorption power of demand. The stronger the demand, the greater the levitation power exerted on prices. Larger profits were made than were normally possible, and these profits represented the wide spread between costs and resale prices. These high prices served to stimulate further production of these commodities but at the same time tended to cut down their consumption, since it is presumably true that lower prevailing prices would have directed more demand in this direction. Productive effort was therefore directed by price into channels more socially desirable. During the market deflation of 1920-1921, prices were fixed by demand, just as they had been during the war, but prices did not cover profits and in many cases did not even cover primary costs of distribution. Demand had practically ceased when consumers went on a "buying strike," and merchandise could not be reduced in supply rapidly enough to meet the reduced demand. Shoes that had been selling a few months before for $17 now had difficulty in bringing $1.95. "Eye-value" was still the chief operating price factor and price represented "what the merchandise would bring." A new direction was being given to demand by prices which might be considered fair prices even though they did not carry profits and costs with them. Deflation was socially desirable, and prices which

did not cover all of merchandising costs were aiding more than anything else to bring this about.

Price-Fixing by the Government.—During the Great War the federal government fixed prices of grain and other necessities in order to give confidence to producers by assuring them a profit, and to prevent the gaining by producers and manufacturers of exorbitant profits as a result of the seller's market developed by war conditions. Price was recognized as a force which directs the production and consumption of wealth, and the government attempted to fix prices which would direct wealth into channels which would be productive of the greatest efficiency in the winning of the war. A minimum price on some commodities stimulated their production; a maximum price on other commodities prevented their production on too great a scale. The natural forces of competition were set aside as determinants of prices, while boards and commissions sought to forecast the economic and social consequences resulting from the prices fixed. The whole price structure is such a complicated one, with ramifications extending in all directions throughout the fabric of society, that many forces were overlooked in the price-fixing. But, for the most part, the governmental assumption of price determination in important commodities served its purpose, viz., a redirecting of wealth into channels subservient to the demands of war and the closing up of channels of productive effort which had no important bearing on the winning of the war.

Price Determining Power of Competition.—Price-fixing is a serious problem because it assumes a redirection of the wealth of the community. Any redirection of wealth should be determined by the automatic forces of industry, the competitive interplay of market influences. Under extraordinary

conditions, when these forces do not act as quickly as they should to redirect wealth into channels made necessary by abnormal circumstances, the government may profitably readjust the price-making machinery. In this extension of power it is justified because its purpose is one of social prosperity. When private organizations, however, undertake to exert this power of price-fixing, a private and hence a selfish point of view dominates the course of action. It is not believed that there is such an overwhelming misdirection of wealth that the government should undertake the permanent responsibility for price determination, and it is not believed that private interests are in a position to know when any misdirection of wealth results from competitive prices. If, however, large retail units come to dominate the field of merchandising and by their combined influences remove the price-determining power of competition, it may appear desirable for the governmental boards and commissions to undertake to redirect demand.

CHAPTER XVI

THE COST OF MERCHANDISING

The Cost of Marketing.—The cost of marketing would include advertising costs, the costs of the manufacturer's sales organizations, the jobber's and wholesaler's costs, and the costs of merchandising. Advertising costs have been discussed in Chapters XII and XIII. The ratio of advertising costs to the retail selling price varies with different commodities, as does also that of the jobber's and wholesaler's costs. In general, it is safe to say that all costs of marketing from the manufacturer to the retailer do not exceed 10 per cent of the retail selling price. In individual instances they may run as high as 20 per cent, while in other cases they may be as low as 2 per cent. From this it is clear that the large "spread" in price between the manufacturer and the consumer is not to be found in the early stages of marketing; it must be sought for elsewhere.

The Cause of Price Spread.—The reason for the wide spread between the manufacturer's prices and retail prices is to be found in the cost of merchandising. This cost, on the average, amounts to about 30 per cent of the retail price of a commodity, varying from 20 per cent on some groceries, for example, to 40 per cent and more on novelties and style goods. Merchandising is, then, the most important field for the study of marketing costs, and an analysis of its cost elements should indicate possibilities for decreasing the spread between the retailer's price and the consumer's price. In the

following analysis of the costs of merchandising, those elements constituting the retail spread will be considered. This spread is called the mark-up and consists of two parts; the costs of doing business, and the net profit. The item net profit will first be considered, after which a detailed analysis will be made of all the different elements which go to make up the costs of doing business, together with plans for reducing costs and narrowing the retail price spread.

The Nature and Cause of Profit.—Profit is the return to the retailer for undergoing a risk. What he could get if he worked for someone else represents his salary, and is an expense item which should be charged against the overhead. Profit is not expense; it is a return which, theoretically, enterprisers must receive in the long run, otherwise they will cease to be enterprisers and enter the employ of others. This decrease in the number of enterprisers, provided the demand for their goods remained the same, would tend to permit those taking risks to get profits which the former intense competition had made impossible. Thus profits are never certain; they are influenced by many complex conditions. But they are, in the aggregate, definite payments which society gives to certain men who are willing to take risks in order that society's needs shall be satisfied; just as interest payments are tangible amounts paid for the use of capital.

It is this part that remains, over and above wages—this "extra"—that business men are presumably after. The proprietor of a business is seeking an extra reward and must put forth extra effort and a higher grade of effort in order to attain it. If the proprietor does the same work as the salaried help and no more, he cannot expect, neither will he often get, more than a salary from his business. Sweeping the floor, opening boxes, keeping books, and such work is not often done by the man who is making profits, yet a proprietor

who does such work often wonders why expected profits never appear.

Developing an Intelligent Accounting System.—The retailer just referred to runs a risk over and above that of his salaried employee, but he gets nothing extra for it because of his incompetence. He is guessing in regard to his store's affairs instead of knowing about them. Some lines of his merchandise sell better than others, but he has no records to indicate to what extent and in what particular lines this is the case. Hence there is no check on bad buying. The mark-up is too low or too high because the operating expenses have not been carefully analyzed. Some of the salespeople are not earning their wages but there is no way of knowing who they are. Other salespeople who are earning more than their wages are not promoted and may became dissatisfied and indifferent. Positive knowledge, evidenced by records, must take the place of guesswork in retailing if profits are to be secured.

How often has a retailer known that his business was increasing more rapidly than his expenses, and yet was not producing a profit? Perhaps when the jobber sent an accountant to go over his books it was found that the books did not tell anything about his business. He kept accounts that did not account. He could not find out, for instance, whether his large assortment of boys' suits was paying him, or whether a big window display of laces would prove more profitable than the display of some other line. In fact, he did not know anything for certain. His energy and enthusiasm were wasted by aimless work. The effective system of accounts does not *do* anything; it points out the work that should be done. System is merely a method of enabling some responsible person to keep his eye on the results of the business. The proprietor or his manager must have a concen-

trated reflection of all that is going on in the business. This reflection, or record, must show at least three things: (1) The location and quantity of the cash; (2) what is owed; (3) the amount of stock purchased, the amount sold, and the amount and location of what is on the shelves.

Attitude of Banks Toward Store Accounts.—Not only from the standpoint of making profits on old capital, but also from that of making profits on new capital, adequate accounts are necessary. Sooner or later every healthy business needs to expand, and needs more credit to do it. Banks are loath to extend credit without a satisfactory statement of the stores affairs, and a day-book and a ledger (all that some stores think are necessary) are insufficient conveyors of information for the banker who may contemplate advancing the increased credit. "There's a popular notion that a man may be expected to know his business," said a banker. "I've grown skeptical about it. A man may be at his desk every day and not know what's happening in his store. The thing that shows whether a business man's request for credit is right or not is the statement he shows you."[1] A test of the adequacy of a store's accounts is whether or not a statement of its affairs on short notice is sufficient evidence on which a banker is willing to loan depositors' money. Can a business statement be produced in 24 hours that will convince a hard-headed creditor that the store is making money? At times some creditors have to be shown.

Importance of Turnover.—In some stores the labor force is working at full speed, but the capital is loafing. In other words, the turnover is sluggish; lifelessness of one factor of distribution nullifies the efforts of the other factor. Large

[1] A. M. Burroughs, A Better Day's Profits, p. 74, Detroit, Burroughs Adding Machine Co., 1912.

stocks are carried and a long time elapses before the capital tied up in them is liberated for new purchases. For this reason the store is handicapped in carrying a large variety of merchandise. A well-selected stock is what the public wants and not a large stock. Very often the large stocks are not efficient simply because they are inactive—they are not used and are incapable of increasing the customer's regard for the store. Moreover, inactive stocks absorb capital that might be used to better advantage. If a merchant invests $1,000 in inactive stock, it would have been far better had he buried that sum in the ground back of the store. There is no deterioration of the sum buried in the ground, neither is there any expense in leaving it there, while in the case of the inactive stock, shelf and floor space must be considered as well as the salaries of salespeople, delivery men and others. Getting the utmost utility out of each unit of capital is just as important as getting a full day's work out of labor.

Capital is turned once when it is invested in stock and all of the stock is sold. A shoe dealer purchased a dozen pairs of shoes at $4 a pair and sold them at $6 a pair. The shoes cost him $48 and were sold for $72. He turned his capital once, at 33⅓ per cent gross profit on the selling price. Another shoe dealer purchased a pair of shoes at $4 and sold them for $6. Then he purchased and sold another pair, and then another, and another, until he had sold twelve pairs. The shoes cost him $48 and were sold for $72. He turned his capital twelve times, at 33⅓ per cent on the selling price at each turn. One merchant makes 33⅓ per cent on his investment; the other makes 400 per cent gross. Both do a gross business of $72, but the important point is that one invests $48 once and the other man invests $4 twelve times. If both of these merchants had $48 to commence business on, one merchant could have invested his other $44 in eleven other $4 items, and by the time the first merchant had sold his

twelve pairs of shoes, the other merchant would have sold twelve of each of the other eleven items.

Figuring Rate of Turnover.—The simplest case of turnover is illustrated by the business of the fruit-peddler. He buys a cart-load of bananas every morning, costing him about $12, and sells them before night for $25. He turns his capital every day, or 30 times a month. On a capital of $12 he does a business of approximately $7,000 during the nine months he is able to work. If the same principles were to be applied to a capital of $12,000, it is hard to realize the enormous business that could be done. To figure the rate of turnover in retail stores is somewhat more complicated than to figure the rate of turnover for the peddler, because a part of the capital invested is released almost immediately and put back into additional stock. On the books, this is apparently an increase in the investment. Stock purchases are much in excess of capital invested, but the sales records show that this stock has been sold. A dry-goods man doing a yearly business of $100,000 on a $10,000 investment, for example, probably puts $60,000 to $70,000 into stock, that is, reinvests his $10,000 capital from six to seven times.

Thus, if the retailer knows the amount of money originally invested, the average amount of stock on hand, and the total amount of goods purchased, he is able to ascertain the number of times he has turned his capital. If the store purchased $60,000 worth of goods, had an average stock of $10,000 and an original investment of $10,000, then the capital of this store has been reinvested six times, i.e., the stock has been turned six times. A common error in figuring turnover is to figure the number of turnovers on the gross business without allowing for the profit on each turn of the capital. For example, if a store has gross sales of $100,000 and an average stock on hand of $10,000, some retailers would conclude that

the turnover was ten. This is a wrong method of figuring, because the profit has been figured in as an investment. If there is a 50 per cent gross profit (based on the selling price) on each turnover, the total stock investment is $50,000. This should be divided by the average stock on hand, say $10,000, which gives a turnover of five. The turnover is the quotient in a process of division; the divisor is the average stock on hand; and the dividend is the billed cost of the goods sold.

An illustration of the importance of correctly figuring turnover was brought to the attention of the writer recently. A jeweler complained that he was not making a profit and could not understand the situation inasmuch as he was making a turnover of 2¼. He had read in a trade paper that profits could be made in the jewelry business if a turnover of this figure was secured. After some calculation, it was found that the jeweler barely had a turnover of one. He had made the mistake of dividing average stock on hand into gross sales instead of billed cost of gross sales. The turnover spoken of in trade magazines and business books usually refers to the investment fraction of gross sales, and not to the entire gross sales. Of course the correct turnover figure can be secured by dividing the selling price of average stock on hand into gross sales. Both factors in the division process include profit, hence one offsets the other. In order to avoid confusion, however, it is recommended that only cost prices be dealt with in figuring turnover.

Cost of Doing Business.—A profit cannot be made unless all of the costs are included in the mark-up. What these costs are is often a matter of disagreement or ignorance. Some grocers have been found who believed that they were doing business on 17 per cent of their sales, when investigation showed that their costs were from ½ to 3 per cent more than this. They wondered why their records did not show a profit

at the end of the year. They had overlooked some very important items of cost, which had the effect of lowering their mark-up on every sale that was made. It might be claimed that the lower price of each piece of merchandise, due to the insufficient mark-up, would stimulate trade and increase sales. This may be true. Trade may be increased enough to equal or exceed the amount lost on all goods by reason of an insufficient mark-up, but if goods are still sold below costs this increased trade will not bring a profit. Stores and industries selling large quantities of goods often end in bankruptcy, and this at the time of their seemingly greatest prosperity. Increased trade does not mean prosperity unless it brings a profit. Trade cannot bring a profit unless the costs of doing business are known and charged against the total business, if not against each sale. The entire cost of doing business will now be considered item by item.

Rent.—Perhaps in every case in which the building is leased a merchant charges rent against the business. When the structure is owned by the proprietor, however, many cases have been found where no rent whatever has been included in the costs of doing business. The former case is no different from the latter. If the retailer who owns his building does not use it himself he receives an income from its use by others. By using the building himself he foregoes the rent which he might have secured from others, and unless his business produces the amount of this rent, his building is unproductive; the capital invested in it does not yield any return. If this were the case with all capital, our vast supplies of capital would soon be destroyed. Of course a depreciation and repair fund may keep the building capital intact, but capital, in order to be productive, must do more than maintain itself; it must add some value to itself. This value is rent in the case of a building, and is a legitimate cost which the business should

bear. Buildings are not free, their use must be paid for; and even though the retailer prefers to pay for his building in a lump sum rather than to pay rent in monthly instalments, his investment must be preserved and augmented to the extent that it would be in similar investments. The amount of rent charged into costs on an owned building should be an amount equal to that which would be received in case it were leased to others. When this amount of rent is taken care of in the costs of doing business, obviously no charge should be made for repairs or depreciation on the building, since these must come out of the rent figure.

Labor.—The item of labor should include all wages and salaries for extra as well as regular work. If it is desirable to indicate the separate expenses of different departments, remuneration for office labor should be kept separate from remuneration for store labor. A common error in accounting is to omit from the charge to labor the salary of the proprietor or members of his family who work in the store, or to charge up but a nominal figure for these services. In many cases where the costs of doing business were below the average, it has been found that the proprietor had failed to charge a sufficient amount for salaries. What the proprietor should allow himself as a salary depends on what he would be worth in similar work to others. Sometimes it is difficult to ascertain exactly what this sum would be, since no offer may have been made for his services from another store. Yet within narrow limits this figure can be ascertained. In some instances retailers have been charging the store with $75 per month for their services, when it was obvious that $200 per month would be much nearer the figure of their competitive value. Cases could also be mentioned where the whole family labored from morning to night without the costs of doing business being affected thereby. As already stated, unless

the costs are put into the overhead and hence into the mark-up, they cannot be secured from the business—to say nothing of realizing a profit.

Depreciation.—The purpose of charging depreciation is to keep invested capital intact—to recoup from the business the annual amount of fixed capital which the business consumes. Fixtures for instance, are consumed to some extent every year of their use but are not entirely consumed. Therefore a fixed amount should be charged off each year for depreciation of fixtures. Twine, postage, and fuel, on the other hand, are entirely used up. In the case of the latter items their total value is obviously an expense, while in the case of the fixtures, only part of their total value is an expense in any one year. Their total value will appear as an expense if viewed over a term of years.

Although this appears clear to many merchants, there are some who do not charge depreciation against fixtures. Because of this negligence, they find themselves at the end of ten or fifteen years with worn and out-of-date fixtures on their hands and no fund except accumulated profits out of which to purchase new ones. Naturally they are reluctant to use profits for this purpose, hence the old fixtures are made to last a few years more during which time the indifferent equipment of the store drives trade away. The store with old fixtures is indeed handicapped in the present-day struggle for trade. More and more, customers are demanding up-to-date stores and fixtures the cost of which they are willing to have included in the price of goods. The progressive merchant does not overlook the demands of the public as regards these items any more than he neglects the character of merchandise which it demands. Only by providing a depreciation fund out of which fixtures may be purchased when needed, is a store certain of an up-to-date appearance in this respect.

The rate of depreciation for fixtures varies for different stores and in different localities. The people in some communities are influenced more by custom than in others. Again, the economic conditions of towns are far from uniform, presenting demands of a varied character for goods and service. Not only is this true as between towns but also in the same town. Because of location, different classes of people naturally patronize different stores, and these stores of necessity adapt themselves to the different demands made upon them. Whatever the demands they should be met, and it should be the aim of every retailer to ascertain continually what these demands are both as regards goods and service. In some stores fixtures will meet the demands of the customers if they are renewed every twenty years. In this case, in order to secure a fund to purchase new fixtures of the same value at the end of the twenty-year period, approximately 5 per cent of the value of the fixtures would have to be charged into the overhead expense every year. If, on the other hand, the fixtures are capable of satisfying the clientele of the store for no more than ten years, approximately 10 per cent of their total value must be included in the overhead expense each year.

It should be clear to every retailer that fixtures do not have to wear out before there is justification for scrapping them. Certainly such a policy is not followed as regards the merchandise. A stock of post-season hats is often sold below cost in order to clear the shelves for something better—something which the customer demands and wishes to see displayed in place of the old goods. Obsolescence, then, is included in the term depreciation. Loss in ability to serve is a loss in value. Not only fixtures but all furniture and furnishings of the store are consumed in instalments, and as these instalments are used up they should be charged into the cost of doing business.

No depreciation should be allowed on merchandise itself. If this becomes less valuable, either through depreciation (fading, shrinking, scratching, breaking, decaying, etc.) or obsolescence (getting out of style, becoming less valuable because of new methods, etc.), it should be either marked down and sold out—in which case the average mark-up is adjusted to take care of mark-downs—or it should be appraised at a lower value in the annual or semiannual inventory, hence decreasing the investment on which interest must be earned.

Repairs.—This item applies to fixtures and equipment of all kinds, but not to buildings. Building repairs, as already noted, are included in rent charges. Repairs are made so as to maintain capital goods at their highest efficiency Repairs differ from additions and betterments; the former seek to maintain the present value of equipment, the latter seek to increase it. Thus, lining up and painting shelving would constitute repairs and should be included under current expenses, while installing glass doors for these shelves would constitute an increase in investment which will not be consumed immediately but by instalments. These instalments are depreciation, and as they fall due should be charged into the overhead expense.

Merchants have been known to increase their mark-up unduly as a result of a high cost of doing business which was inflated with the cost of improvements. In a certain variety store this procedure made such an extraordinary increase in prices of goods, the demands for which were more or less elastic, that trade fell off rapidly and a forced sale resulted. An overhead that is too high is as dangerous as one that is too low. In the latter case trade is increased—but not at a profit; in the former case trade is decreased, which augments still further the overhead, although on individual sales a profit is made.

Supplies.—Wrapping paper, twine, bags made of paper or burlap, baskets, stationery, pencils, and the like, are included in the item supplies. If possible, the office supplies account should be kept separate from the store supplies account. This makes easier the task of analyzing expenses, and as all expenses are kept for the purpose of analysis, a confusion of the two wastes the time and effort expended in keeping them. The error usually made in connection with supplies is that of forgetting to charge them. The individual supplies are often of little value and therefore appear of little significance, but taken in the aggregate they loom large. Omitting to include them may mean the difference between a profit and a loss. In order to guard against this error, every time supplies are purchased a purchase slip should be made out, stating the amount and character of the purchase, and placed on a spindle to be totaled at the end of each day and added to the list of the expenses of the store.

The expense involved in supplies is easily lost sight of if boxes, barrels, stationery, ink, pencils, and so forth, are taken from stock without any record being made of the fact. In a small store it is often believed unnecessary to make a record of such a transaction, since what the stock has lost the store has saved by making unnecessary a purchase from another source. It is assumed that one offsets the other. Such is not the case. Unless the customer is charged with those supplies, he never pays for them; and he is not charged for them unless they are included in the overhead and consequently in the mark-up.

Similar to this error is that of allowing the proprietor or members of his family to take dry-goods, groceries, or other stock for the family use without having them charged. Instances continually come to light in which this practice has become a custom. One proprietor justified himself by saying that he was not charging much salary against the business,

only $50 per month. He did not realize that he and not the business paid for stock used in this way. Certainly the customer did not pay for it, because this expense was never charged to the overhead, and consequently was not included in the mark-up. If in this case the proprietor wished to regard withdrawals of merchandise as part of his salary, he should have included the value of the goods in the costs of doing business. Instead, however, of charging the value of the goods directly to overhead when merchandise is taken out of stock for the proprietor's family use, it is generally better for the proprietor to allow himself a salary sufficient, at least, to pay for the goods in cash.

If the proprietor wishes to defer payment for goods taken for family use, he should charge them to himself on the same basis that he would charge them to customers. The customers, not the proprietor should be made to pay salaries.

Interest.—All interest on notes, mortgages, and so forth, by means of which money has been borrowed to carry on the business, should be charged against the costs of doing business, for such interest is an accounting cost, i.e., one that must be paid out of the earnings of the current year. When competition permits, some merchants also charge off interest on the net amount of the total investment. This procedure is advocated for all retailers by the National Association of Credit Men and others, who regard interest on investment as an economic cost and one that must be earned by merchants in the long run and charged to the cost of doing business. Those who are on the other side of the question assert that if all merchants accounted for interest on net investment in this manner, prices set by the less efficient would be above what competition allows. Able accountants are on both sides of the question, over which much controversy has raged.[2]

[2] *American Economic Review,* Proceedings, 1918.

Those who are opposed to the inclusion of interest in the cost of doing business assert that, as selling prices are fixed by competition, the retailer makes as much interest when it is omitted from the overhead as when it is included. When the merchant includes interest on the investment in the cost of doing business, they urge, the latter will be a larger percentage of the gross profits, and net profits will be smaller; when interest on investment is not included, the cost of doing business will be smaller and net profits larger. According to those who hold this view, if the net profits were 10 per cent, part of this amount, say 6 per cent, would have to be regarded as interest on capital, and the balance, 4 per cent, would constitute net profits.

Those who urge the inclusion of interest in the cost of doing business section of the mark-up are undoubtedly correct in their view that interest on investment is an economic cost, but it does not necessarily follow that all of the economic costs will be paid by the consumer. In the last analysis, competition determines what the consumer pays; and competition can, and often does, force prices below a point sufficient to cover accounting plus economic costs. It is true that if the merchant is to remain solvent, competition cannot force prices below a point sufficient to cover accounting costs, i.e., costs which the retailer must pay to others. Still, the retailer can remain solvent even though all the economic costs, one of which is interest on net investment, are not met; because in the case of economic costs, the retailer is his own creditor.

The assumption that economic costs must be met or merchants in general will not put their capital into merchandising is not correct. It is true that some retailers go out of business because they are not successful, i.e., are not making interest and profits, but this in no wise cuts down the number of retailers. The number of retailers is increasing more rapidly than ever before. Consumers must pay interest only if their

failure to do so would cut down the supply of retail service, and it is quite evident that the supply is not being cut down.

Three reasons may be given why some retailers remain in business and others enter the field even though economic costs are not paid by society:

1. Accounting costs may be reduced.
2. Retailers are generally ignorant of the fact that economic costs are not met.
3. There is a combination of money returns and advantages which they consider sufficient recompense for their personal efforts and capital invested.

Reduction of Accounting Costs. If, because of competition, gross profits cannot bear the item of interest on net investment, better merchandising methods in regard to turnover, selling, advertising, store arrangement, and the like may be adopted to secure it.

Ignorance of Economic Costs. One reason for the continuance of the supply of retail service in face of the failure of society to meet all the economic costs is ignorance on the part of new retailers. They do not know that all economic costs are not being earned. Of course they know that there are many business failures, but they have no means of knowing that many of the so-called business successes are in reality business failures. Financial failures get into the newspapers, and into Dun's or Bradstreet's, and serve as warnings; but business failures are secret, often not known by the proprietors themselves. Hence they cannot serve as warnings. Yet there can be little danger of error in stating that a business that does not earn interest on its investment is a business failure. It does not help the situation to know that the capital is owned by the proprietor. If the capital were owned by an outsider and interest was not paid when due, the business would be forced into the hands of a receiver. In other words, financial failure would result.

Advantages of Proprietorship. Even when the retailer realizes that economic costs are not being paid by the buying public, he may choose to remain in business. There may be a combination of money returns and advantages which he considers sufficient recompense for his personal efforts and the capital he has invested. This reward may be less than the economist believes the retailer should get, but the fact remains that the true cost of retailing is measured alone by the minimum reward which the retailer will accept. Below this minimum prices cannot go without a withdrawal of the supply of retail services. The compensations that offset the loss of money costs are not hard to find. The retailer is his own boss. He has a feeling of independence derived from his proprietorship which he values highly. He is willing to forego certain money returns if he can preserve this independence. He may be willing to supply his services even if neither interest on investment nor profits are received. Interest and profits, then, are not necessarily costs that must be met in order to get retail service viewed in the aggregate. It is true that a retailer may quit business because he does not get what he considers his costs, but just so long as these vacancies are filled promptly by newcomers, just so long will the supply of retail services remain unreduced.

Economic Costs in the Professions.—It is doubtful whether all economic costs are paid in any field of activity. College professors are spoken of as being "underpaid," a statement which must mean that in view of their investment professors are not getting adequate returns. But from whose standpoint? Assuredly not from the standpoint of the professor himself, because he persists in his profession and new human material enters the profession as the old wears out. A four years' college education plus three years of professional training, costs, on the average, for the seven years, $10,000 (allow-

ing $600 for nine months' college expenses each year and $900, or $100 per month, for deferred earnings). That society has to pay to each professor every year $500, or 5 per cent interest on this sum, in addition to what his teaching labors are worth, does not necessarily follow. One may argue that this interest charge is already levied upon society and is included in the wages of teaching. This has little semblance to truth since a subtraction of $500 from the salary of every professor would leave a balance much below the wages of a common day laborer. The solution of the difficulty must be obvious. The costs of the professor are higher than those of the day laborer, but he does not withhold the supply of his services from the market in case these costs are not met. Many compensations apparently serve to offset the failure of society to pay the money costs involved. These compensations may differ in individual cases, but some of them may be enumerated, as for instance, opportunity for independent research, library or laboratory facilities, freedom from care, certainty of tenure, social esteem, love of work, absence of exacting supervision, vacations, etc.

Costs have a wide range of elasticity. The minimum costs must be met if a supply of either professional or retail services is to be forthcoming, but the maximum costs (all of the costs) can be secured only in exceptional circumstances, usually those of monopoly. Competition tends not only to eliminate profits, but also to prevent a recovery of the entire economic cost. No matter in what field of endeavor, society gives only sufficient remuneration to insure the prompt supply of services. More remuneration would stimulate oversupply, while less than this minimum would fail to bring a sufficient supply to the market. Competition, then, regulates returns; not some external being's belief of what is "fair" or "proper." All that can be given as regards costs is an enumeration of what are usually considered costs.

CHAPTER XVII

THE COST OF MERCHANDISING (CONTINUED)

Bad Accounts.—All dead accounts should be charged into the cost of doing business. When are accounts dead? After every effort made to collect them has resulted in failure. How many efforts should be made? This all depends on the individual case. In some cases it may be evident thirty days after the bill is due that no hope can be held out for its payment. Possibly the debtor has moved away, or has become incapacitated so that he is unable to fulfil his obligation. In other cases, a year or two may possibly elapse before all hope as to final collection need be given up. A judgment must, however, be made on each account as to its collectibility, after all of the facts pertaining to it have been carefully analyzed. Mistakes will naturally be made in a small percentage of these judgments, but it is better to have some such definite policy of deciding on the merits of old accounts than to let them drag along unsystematically in the vain hope that for some reason or other they may prove of value.

Percentage of Bad Debts.—Profits are a return for those risks of business which cannot be insured. The risks of bad debts can be insured. They are usually a quite definite percentage of the gross sales. This percentage should be determined and placed in the cost of doing business; otherwise it will not be paid by the customer. The difficulty in arriving at a working percentage is usually due to the reluctance with which retailers admit the worthlessness of an account. Long after its uncollectibility is established some vague hope of

collecting it may remain, hence official cancellation of it may be postponed for another year. An account is usually declared worthless only when the circumstances related to it become blurred and unfamiliar in the mind of the creditor. How difficult it is for retailers to admit their losses and write them off the books is evidenced by investigations made by the writer which showed accounts 5, 10, 15, 20, and 25 years old. These accounts were listed each year as assets and served to fool the proprietor into thinking that his business was more prosperous than it actually was. Willingness to take a loss is part of business courage, but the retailer takes the loss whether he is willing or not. Refusing to recognize the loss does not eradicate it; it is still there whether it is called an asset or a liability. When not recognized as a loss it is met out of business profits, but when recognized it is being paid for by the customer.

Effect of Bad Collection Methods.—Bad accounts are not as they are often believed to be, predetermined. They are very often the product of bad collection methods. In other words, retailers may be the means of killing some accounts. Most accounts in order to live need an airing at least every thirty days. Bills sent regularly to the debtor are the only means of communication between the account and its creator, and as long as these are received a spark of life exists. The moment he no longer receives a bill, the debtor feels that nothing more is expected of him and that his obligation ceases. If the collection methods are faulty, he may after several months receive another bill, but it impresses him lightly. It is as a voice from the dead and the hard-headed debtor does not believe in spirits.

A merchant who lets a debt get stale is creating bad accounts. When is a debt stale? At the moment it could have been paid but was not. When can any debt be paid?

After pay-day. In some localities the clientele of a store are paid weekly, in others semimonthly, in still others monthly. Or, part of the store's customers are paid at the end of one of these periods, part at another, and part at still another. At any rate, there should be an understanding just when the account is due, and it should be due on pay-day whenever that is. The customer should be held to his agreement to settle accounts on pay-days or some good reason should be given for not doing so. Unless this is done the death warrants of a good many accounts are signed.

The retailer should realize that he has not only the power but also a duty to create paying habits. This is not only a duty to himself and to the prompt paying customer who must eventually pay higher prices for goods because of the bad debts of others, but also a duty to the careless customer. The latter, if left to his own devices and tendencies, becomes improvident, shiftless, and irresponsible. If only the customer suffered it would be of little public concern, but the harm does not stop there. His wife and children are handicapped and lose their self-respect. It is for the sake of the latter that more efficient collection methods should be followed in the future. Cases are known where improvident customers have been made thrifty, reliable citizens by a determined retailer. He can often do more to encourage thrift than the banks because he comes into intimate contact with great numbers of people who never step into a bank.

Credit Associations.—In spite of all that might be done if retailers were more strict in collections, the fact still remains that long credits to customers exist. Why is this? Chiefly because of intense competition. Under such conditions, the only remedy lies in the formation of a credit association in which all the merchants of the community have membership. After such an organization had been formed in a certain town,

investigation showed the startling fact that in the majority of cases the debtors of each store were the same persons. Very promptly these irresponsible customers found themselves barred from credit purchases in any store in town. The merchants in that town would not think of going back to the old haphazard way of selling on credit. They have all gained by co-operation, and the irresponsible as well as the responsible customers are better off because of the new method of handling.

Operation of a Credit-Rating Bureau.—A credit-rating organization functions as follows: In the first place, a central agency is necessary where each merchant in the organization can send his ratings of customers, and from which he can at a moment's notice secure the rating of any customer. The equipment of this central agency, or clearing house of information, need be but a single room with card indexes of customers and their ratings in charge of a capable person, usually a woman. On each card, which should be about 3 by 5 inches, is the name of an individual, the code number of the merchants who have reported on this person, and opposite this code number the rating which these have given with the date of each. The merchant's identity in each case is obscured by a code number, so that anyone looking over the files would be unable to tell the source of the individual ratings. The date is given so that the value of each rating is apparent.

To illustrate this system, it may be supposed that there are 100 merchants in the credit organization, each of which is given a number somewhere between 1 and 100. Habits of paying may be represented by A for 30 days, B for 60 days, C for 90 days, D for beyond 90 days, and E for hopeless. These symbols may be still further interpreted as follows: A prompt; B good; C good, but slow; D risky, very slow; E bad. Obviously more classifications may be made if cir-

cumstances demand. In view of this information a card may appear as follows:

John Jones, 1718 Falkner Street, City
Occupation—machinist Term of residence—3 years

78—A Feb. 10, 1921
17—C Feb. 11, 1921
6—A Feb. 16, 1921
82—B Feb. 19, 1921
45—A March 14, 1921
64—A March 22, 1921

Let us say that John Jones enters a certain store for the first time and asks permission to charge his purchases. The proprietor or his office girl calls up the credit bureau and asks for a rating on John Jones. The credit bureau's secretary replies: "Four A's, one B, and one C, February and March." This store then knows that it has a prompt-paying person as a prospective customer and accordingly it extends him credit. If three of the ratings were D's and three E's, it would very probably be wise to sell the customer goods for cash only, or C. O. D. Of course if the retailer desired to extend the customer credit he could do so, but he would be taking the risk with his eyes open. Very often this has happened. In their efforts to get trade merchants have disregarded the warnings of the credit bureau, but, like the mariner who disregards weather signals, have usually lived to regret their action. In communities where the credit bureau has taken root, retailers abide by its indications and do not take unnecessary risks.

The Secretary.—As with every system, there are difficulties encountered in running an efficient credit bureau. One of the greatest of these is the failure of members to report ratings regularly and promptly. The value of any credit bureau

increases directly with the number of ratings. If the members become lax in making their reports, the bureau soon falls into disrepute. However, in order to be able to determine the value of any ratings that do exist, it is necessary to give the date of each rating. Usually the value of any individual rating decreases directly with its age. Hence the necessity of keeping it up to date, a duty which an enthusiastic, energetic secretary can accomplish more successfully than anyone else. The secretary can make or break the system. Merchants do not intentionally disregard making reports, but they neglect them because of other duties. An energetic secretary gets these reports either over the telephone or in person. Usually it is difficult to go for them in person because her presence is required at the office during business hours. If a merchant calls up the credit bureau for a rating and fails to get a reply, he will in all probability extend credit to the applicant; and, unfortunately for the credit system, he will be much more inclined to use his own judgment the next time a demand for credit arises. When a few of the leading merchants succumb to this habit, the efficiency of the bureau is materially lessened. Likewise, if the telephone of the credit bureau is always busy, requesting merchants to report customers, other merchants who desire to get ratings may be unable to do so. Rather than to keep the customer waiting the merchant will use his own judgment in extending the credit.

Methods of Meeting Expenses.—There are several different methods of meeting the expenses of credit-rating bureaus. One method is for each member of the association to pay his pro rata share of the expenses, estimated in advance. Another plan is for each merchant to pay according to the number of calls made for ratings. Neither of these is very satisfactory, because the first lays an equal burden upon both the small and the large merchant, while the latter serves to

reduce the number of calls made for service and endangers the revenue necessary for meeting expenses. Perhaps the most satisfactory method is to apportion the expenses (estimated in advance) according to the gross sales of each merchant. This is based on ability to pay as well as service rendered, and is usually quite satisfactory to both large and small merchants. The total expense of running a credit bureau in a town of 15,000 inhabitants is about $750 a year. Obviously, the location of the bureau office and the elaborateness of its equipment will to some extent determine the costs, but the main expense is the secretary. Generally speaking money is not saved by hiring an inexpert secretary. If price reflects capability, a high-salaried secretary is the least expensive in the end.

Causes of Failure.—The main cause for the failure of credit bureaus has been the delinquency of retailers in reporting ratings. Having installed the system, merchants often think that their duty ceases. They appear to believe that it will automatically render service without their aid. They hire a secretary to take care of the details and feel that she should make it a success. In some cases merchants have even been known to resent a call from the secretary for rating information. Only when each merchant feels his responsibility in making the system a success will it be a success.

Another cause for failure has been the refusal of many merchants to join the association after it was formed. This reluctance on the part of some to co-operate for better business and for community welfare has sometimes even prevented the organization of credit bureaus. Many communities do not have a credit bureau because of the inability of the merchants to "get together." However, where some merchants refuse to join, it is still to the advantage of those progressive enough to see the possibilities of the organization to put the

matter through, with the hope that those who are holding back will join later when the benefits of co-operation are known to all. The experiment often has to be performed by the daring few. Others, later on, are glad to come in for the benefits. Such a condition must be expected; a community would grow old waiting for equal initial co-operation from all who would be benefited.

Delivery.—All delivery expenses are a cost of doing business. This item includes: the cost of vehicles used to transport goods to customers' homes; supplies; repairs; garage and stable expenses; the cost of labor necessary to supervise and carry out delivery; depreciation and obsolescence of equipment. The delivery expense should be kept separate from the general expense of the store, since failure to separate this expense makes it impossible to determine its percentage of the gross sales. If this item were not kept separate, it would be impossible also to compare the store's delivery expenses with delivery expense percentages found in trade journals and those given by other merchants; and furthermore, if for any reason delivery should be discontinued, it would be difficult, if not impossible, to know what reduction to make in retail prices.

During the Great War when conservation made popular the "cash and carry" system, merchants all over the country were confronted by the problem of making reductions in the price of goods that were carried by customers. Not knowing the actual costs of delivery, reductions were made by guesswork. As a result 5 and even 10 per cent reductions were made. In these cases the actual delivery expense no doubt ranged from 3 to 4 per cent. A policy of making reductions in so unscientific a way, if it were to be continued for any length of time, would consume a large portion of the business profits.

"Cash and Carry" versus Delivery.—Many merchants would like to see the "cash and carry" system perpetuated. This is true because there has been much waste in both credits and deliveries. Customers have demanded several deliveries a day, often of insignificant articles. If one merchant has attempted to keep pace with the more extensive demands, others have been forced to follow. Competition of service as well as of goods has thus duplicated and extended service until the costs of delivery have mounted higher and higher, and the prices of goods have risen to meet the new costs.

Yet the "cash and carry" system will not displace the present system. Credit and delivery are not bad in themselves. They are valuable services which the customer can ill afford to give up, and economy would not be secured by having customers carry their purchases. Lack of delivery would entail greater expense upon the community than the present inefficient system; burden-bearers are not efficient people. It is the abuse of these services that must be corrected. Earlier in this chapter it has been stated that credit abuses are partly the fault of the retailer, and certain methods have been advanced for correcting present inefficient methods of extending credit. It is our purpose here to show wherein the delivery system may be made more efficient. Greater efficiency is merely another term for lower costs, and the latter has ever meant a lower price of goods to the consumer when competition has been active. That it is active in retailing few will deny.

There is no doubt that there are abundant opportunities for greater efficiency in individual delivery equipments. Better routing, more economical and up-to-date vehicles, savings in labor, and so forth, may cut down the delivery costs of any store. But it is not these wastes so much as the great waste of duplication, viewing the stores as a whole, which commands the attention. Half of the amount of labor and

capital expended on delivery service is unnecessary. If all of the communities of the United States were included, the excessive amount of labor and capital used for delivery purposes would reach a huge figure. This superfluous expenditure is paid for by consumers.

Central Delivery Systems.—There are several methods of eliminating this duplication of effort. All of them are included under what are known as central delivery systems, and are more or less co-operative in character. In the first place, there is the system in which the merchants' equipment is purchased by an individual who manages a central delivery for profit. In the second place, a corporation with its own equipment is given the privilege of operating a central delivery, the merchants having no direct control. In the third place, there is the co-operative system in which the merchants hold stock and have control through a manager.

A Co-operative Retail Delivery System. — The latter method of central delivery has had quite extensive success and deserves some detailed attention. A description of a typical system now in operation will serve to indicate how it is conducted:[1]

> By a co-operative system of delivery, the merchants of Ann Arbor, Mich., give a service of five deliveries a day within the city limits, a service conceded to be far more satisfactory than the former one and employing only seventeen wagons where seventy would be operated by the old individual method, so that with the improved service there is also greatly reduced expense.
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> This system was inaugurated in Ann Arbor in 1907. A company was incorporated, capital stock $10,000, shares $10

[1] W. S. Bittner, Co-operative Retail Delivery, Bulletin of the Extension Division, Indiana University, Sept. 1917.

each. Twenty-two merchants took twenty-five shares each, providing a working capital of $5,500.

A suitable lot was at once purchased, 80×132, at a cost of $3,600, and a central station erected, costing $7,800. So the new company started out with a considerable indebtedness, all of which has been wiped out, however, in less than seven years, and an adjoining lot bought and paid for at $2,500.

Deliveries are made for any merchant. Members, however, buy their coupons at a lower rate than non-members. After deducting the income from the deliveries for those who are not stockholders of the company, the balance of the expense is pro-rated among the stockholders in proportion to the number of deliveries that are made for each. Grocers who are members pay 3⅜ cents for one delivery, while the charge to grocers who are not members is 4⅛ cents. (Rates were increased in 1917.) A grocery delivery is an order of less than 100 pounds to one address in one, two or three baskets.

Stockholding butchers pay 2⅜ cents per delivery while nonstockholding butchers pay 3⅛ cents. (Rates were increased in 1917.)

All coupons, or rather, tags, are sold for cash and in lots up to 100, 200, 500, 1,000, and 2,000. The merchant uses one tag for each order (delivery to one address), filling in not only the name and address of the customer, but also the number of the route. The entire city is divided into sixteen routes and each merchant has a route book, printed and alphabetically arranged as to the streets, so that the route number of any address is instantly found in the index, although, of course, the merchants and their clerks are very familiar with the routes now and are seldom obliged to refer to their book. Each merchant also stamps his coupons with his firm stamp, so the tag (coupon) tells the whole story on its face; its price, the firm, the customer, and address, and the route number.

In the morning the drivers report at the central station at 6:15 and start out with their wagons. Each driver has certain stores to which he delivers the "empties" (each merchant provides his own baskets or boxes, marked with

his name) and from these same stores he collects the orders to be delivered, returning to the central station with them. The wagons are then backed up to a long bench or shelf, running down the center of the station, and the baskets and boxes are unloaded and shoved along according to the route numbers on the tag, so as to distribute the orders to the proper wagons in a very few moments. As the driver delivers, he takes the tag off the order and these tags are turned in at the office, tied and stacked in each merchant's name and held for a time for reference in case of complaints, or for checking up.

In coming back to the central station after delivering, each driver stops at certain stores most convenient to his line of travel, leaves whatever "empties" he may have belonging to these particular stores, collects the orders that are ready, and brings them to the central station. Each merchant gets back all of his "empties" at noon and in the morning.

For C. O. D. orders, envelopes are furnished instead of coupons and for these, merchants pay 1/8 cent more than for the straight delivery tag. All the drivers are under bond. Making the collection is quite a service.

On a recent Saturday the company made 3,348 deliveries, including 315 C. O. D. orders. It should be stated that the drivers work from 6:15 A.M. to 5:30 P.M. and on Saturdays to 7:00 P.M.

Provision is also made for the delivery of consignments to merchants from out-of-town shippers, such items being a matter of $50 a month to the company and are easily handled, the same as returning "empties" to the merchant.

Another source of revenue is the service for package delivery for citizens who telephone for a wagon to take a bundle to the washwoman, or any service of special nature. Still another source of revenue is from 5-cent and 10-cent coupons for shoe, clothing, dry-goods stores.

There are eighteen routes, but the company has twenty wagons and twenty-one horses. Two Ford automobiles have been put on recently to take care of special deliveries. Eighteen drivers are employed. An extra driver handles special calls, which include service from the railroads to

the merchant. A day barn man and a night barn man, with bookkeeper and manager or superintendent, complete the force.

An idea of the expenses may be gained from the following figures for 1913:

Pay-roll	$13,547.65
Feed bill	2,437.02
Light and fuel	170.68
Repairs	613.85
Horse account (lost 2 horses)	325.00
Wagon account	210.00
Horseshoeing	604.05
Harness	84.25
Claims (damaged, broken, etc.)	117.24
Miscellaneous	930.38

The customers, since the installation of this system, have been well pleased.

A Privately Owned Central Delivery System.—In Janesville, Wis., is found an illustration of a privately owned central delivery system, owned and operated by two men who claim to operate at two-thirds the cost of the former individual system. This private system has no rigid contracts with the merchants, the latter being under no obligation to use the service if they are not satisfied. The system makes good lost orders, damage to goods, and uncollected C. O. D. orders, and furnishes all equipment. Peter V. Kuhn, general secretary of the Commercial Club of Janesville, gives a brief description of the system's operation as follows: [2]

So far as the merchants are concerned the delivery system here is not really a co-operative system. It is operated by a private company. The men who organized this com-

[2] W. S. Bittner, Co-operative Retail Delivery, Bulletin of the Extension Division, Indiana University, Sept. 1917.

pany made a study of what it was costing each merchant for his deliveries when they were undertaken individually. This information was gathered by making inquiry of the merchant himself and also his fellow-merchants as to their estimate of each other's business. When these men had satisfied themselves thoroughly as to what it was costing each merchant to make deliveries, they went to each individual merchant and offered to take charge of his deliveries at a definite fixed price per week, which they knew to be less than it was costing the merchant. These figures, I believe, were simply based upon the former cost to the merchant himself, and they do not vary from week to week. Each merchant simply pays a flat sum for his own deliveries the year round. In this way it is proving less expensive than formerly, and in addition, the merchant is relieved of a great deal of trouble.

The Janesville Delivery Company is giving perfect satisfaction, and handles deliveries for all kinds of merchants.

Percentage Cost of Delivery.—Whether the central delivery system is owned by private individuals, a stock company or co-operatively, the outstanding feature of nearly every system is a material reduction in the costs of delivery. This reduction runs from 20 to 50 per cent. Exact figures are difficult to secure because many merchants have failed to keep an exact account of delivery expenses. But it is safe to say that on the average any of the three methods of central delivery will reduce delivery expense from one-fourth to one-third. In individual cases it may be more or less than this.

What saving this would be on the gross sales can be determined only by ascertaining to what percentage of the gross sales delivery expense usually amounts. Investigations differ on this point. One study[3] concludes that the total

[3] Harvard University, Bureau of Business Research, Expenses in Operating Retail Grocery Stores, Bulletin No. 5, Cambridge, Mass., Harvard University Press, 1915.

delivery expense of retail grocery stores varies between 1.1 and 5.9 per cent of gross sales, with an average of 3 per cent. The delivery expense amounts to about 18 per cent of the total costs of doing business. Another report[4] indicates that the delivery expense of grocers is from 5 to 7 per cent of their gross sales. National delivery cost standards found in another investigation[5] are as follows: grocers, 2.53 per cent; department stores, 2.01 per cent; dry-goods, 1.02 per cent; clothing, .65 per cent; drugs, .51 per cent; shoes, .46 per cent. In department stores the cost of delivering an average package, regardless of size, ranges from 5 to 8 cents, while the run of distributors pay from 5 to 11 cents.[6]

From a statement of the percentage costs of delivery, it is seen that a saving of from one-fourth to one-third of delivery costs would amount to a saving of from 1 to 3½ per cent of the gross sales. In other words, in a grocery business with gross sales of $50,000 there would be saved from $500 to $1,750 per year; in a department store with gross sales of $200,000 there would be saved about $2,000 per year; while in a dry-goods store with gross sales of $100,000 a saving of about $500 would be made. All of these are substantial savings which any store can ill afford to lose unless there are some gains from individual delivery which offset the loss. Are there any such gains?

Objections to Central Delivery Systems.—Obviously, an individual delivery system enables a store to render special service to its customers. Competition between stores is usually keen, and a delivery system offers great possibilities for rendering service which will impress the customer. To sacrifice this

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[4] A. H. Andrews, Co-operative or Central Delivery System, unpublished report, New Britain, Conn.

[5] Wheeler Sammons, Keeping up with Rising Costs, Chicago, A. W. Shaw Company, 1915, p. 98.

[6] *Ibid.*, p. 99.

real or imagined advantage in the hope of some offsetting gain is sometimes a formidable stumbling-block to the introduction of a central delivery system. Yet the advertising value of the individual delivery may be costly because of an overestimation of its effectiveness. "Most store delivery wagons advertise a store's weakness, for the best delivery service makes frequent errors and *one* error makes a stronger impression than one hundred deliveries perfectly made." [7] The central delivery makes errors, although perhaps not so many in proportion to the merchandise delivered as do individual deliveries, but most important of all, each error does not count so strongly against the individual merchant. He is blamed by the customer no more than his competitor is blamed.

No doubt one of the chief reasons why more central delivery systems do not displace individual systems is that merchants do not desire to be dictated to from the outside. They have built up their business and feel confident that they can continue to carry it on without outside help. This strong individualism is hard to contend with and has wrecked more than one scheme of community co-operation. Only a tactful leader can induce such men into a co-operative enterprise. Only too often the mistake has been made of attempting to drive them. They must be convinced of the system's advantages. This means a command of knowledge regarding the systems that have been tried out, with data of costs, methods of working, management, and so forth. Ignorance is always an obstacle to new and more efficient methods and often takes the form of an extreme individualism among certain kinds of merchants. The breaking down of this barrier to co-operative understanding must be accomplished if delivery costs are to fall.

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[7] W. R. Hotchkin, *System*, July 26, 1917.

Adapting System to the Community.—A central delivery system co-operatively owned and operated by the merchants is not the only form that co-operation in reducing delivery costs may take; any concerted action among merchants to abandon their individual deliveries and to agree to have some centralized agency perform this task is co-operative. The agency may be any one of three already discussed. Which of these is the most satisfactory under all conditions is difficult to say. All three have proved satisfactory under different conditions, and it is safe to say that each has its advantages. Some communities have awakened more than others to the advantages of co-operation, hence the system must be adapted to the community rather than the community to the system. Private ownership of a central system may be the most practicable means of starting a movement which eventually may be taken over by a strictly co-operative organization.

CHAPTER XVIII

THE COST OF MERCHANDISING (Continued)

Advertising.—Newspaper, window display, direct-by-mail, poster, and street-car advertising, and other publicity methods and devices are included in the costs of doing business. The larger the business, the greater the necessity for keeping each of these advertising expenses separate. By so doing, increased sales during a particular period may be intelligently traced to their cause, which may have been the extensive and careful utilization of some one factor of publicity. Generally, of course, all merchandising factors blend to produce a result; even then, an effectual analysis of advertising is the only sure way of making publicity increasingly effective.

Percentage of Gross Sales.—Generally speaking, retailers, especially the smaller ones, spend too slight a percentage of their gross sales on advertising of all kinds. Very often they spend not more than ¼ per cent. Experience has shown that on the average at least 3 per cent of the gross sales should be spent on this item. In some cases merchants have found that 5 per cent is not too high. Only a careful study of results produced from advertising can determine, in the long run, just what percentage is the most advantageous for each merchant. Competition, the character of the clientele, facilities for advertising, and other factors must also be taken into consideration. To lay down a definite percentage of gross sales that should be expended in individual cases is extremely difficult, yet it is well for the retailer to take note of the amount usually spent by successful stores, and to adhere quite

closely to a proportionate percentage, unless there are special reasons for not doing so. Such an amount for any merchant lies somewhere between 2½ and 3 per cent of the gross sales.

Inefficient Advertising.—More important, however, than quantity of advertising is quality. Much of the money spent in retail advertising is thrown away. This is true because ill will instead of good-will is created by it. In other words, the elementary principles of advertising are not followed; the writing of the advertisement is often deferred until the last minute, and in some cases is turned over to the newspaper publisher. Because increased sales do not result from such advertising, retailers grow to feel that advertising is ineffectual as a means of increasing their business and place it in a subsidiary position in their scheme of procedure. Only by following the principles of advertising and turning over the copy to some one competent to do the work will expenditure for this item produce its maximum possibilities.

In the small store, advertising is usually inefficient because the proprietor assumes the duty of copy-writing, together with a hundred and one other duties. The sooner the small retailer realizes that he cannot do everything himself, the more efficiently will he function. There is usually someone in every establishment who is better adapted for writing copy than anyone else. He may be the proprietor, and he may not. Some obscure clerk, if given the responsibility, may do the work with distinction and profit to all concerned. At any rate, it is only by co-operating with those working in the same store that all the varied duties of retailing can be worked out efficiently.

Segregating Advertising Expenses.—It has been indicated that it may be desirable in some cases to keep the expenditures for different kinds of advertising separate. It may likewise

be found desirable, especially in the larger stores, to keep the advertising for each department separate. Thus, if a large amount of window space, newspaper, and poster advertising is used to call attention to the goods of any one department, that department may be made to bear the advertising expense, or, even if other departments are made to bear it, it may be known for what department the expense was incurred. The most direct relationship between effort and result is thus secured, and misapplied energy is reduced to the minimum.

Subscriptions and Donations.—Demands for subscriptions to community enterprises and donations to worthy causes are constantly being made upon merchants. Under certain circumstances, such payments come legitimately under the costs of doing business.

Good-Will. In the first place, these contributions may be made in order to secure or maintain the good-will of certain individuals or organizations. This may be viewed as a species of advertising, not with a view toward immediately increasing sales, but rather toward building up the good-will and reputation of the store. It is well, however, to keep these items separate from advertising expenses, for purposes of analysis, since they are a special kind of advertising. On the other hand, if these subscriptions and donations are requested from the merchant as an individual and not as a merchant, they are not legitimate costs of doing business. For instance, if a merchant is a Methodist and is asked to subscribe to a church celebration, he should not call this subscription a cost of doing business if other Methodists, no matter what their business, are making subscriptions according to their ability to the same cause. If, however, he subscribes more than his private income permits because he sees increased business in the venture, the amount in excess of that which he would have subscribed had he not been in business should be charged to the costs of doing

business. Moreover, if the Catholics, let us say, request a subscription for a similar end from the Methodist merchant, all of the amount subscribed should be charged to the costs of doing business, because none of this amount would have been subscribed if the subscriber had not been in business.

Instances have come to light in which merchants have charged to their business, commercial club dues, subscriptions to the cost of erecting a memorial to the community's soldiers who fell in the Great War, Red Cross subscriptions, and the like. These items are not strictly costs of doing business, since others in the community who are not in business have given to the same or similar causes in proportion to their ability and have accepted the charge as one against their personal income, not attempting to secure it directly from those to whom they were selling their services or goods. It may be argued that it is right to make such charges against the cost of doing business, since the proprietor does not take a large enough salary out of the business. But, as already indicated, the proprietor should take out a salary equal to that which he could earn in the same capacity if he worked for someone else. If he does this there is no occasion for reimbursements from other accounts, while if he does not do this the reimbursements from other sources merely cloud the accounting situation and prevent accurate analysis. The first principle in store accounting is to attach a legitimate name to each item, and thus avoid misunderstanding.

Direct Returns. In the second place, subscriptions and donations which bring direct returns to the store are correct charges to the cost of doing business. It is known that a "sauerkraut day" (Walnut, Iowa), or a "fried fish day" (Beardstown, Ill.), brings people to town and directly results in increased retail sales. Obviously people who are not in the retail business do not benefit from such occasions as much as merchants, and therefore the latter should defray the bulk

of the expense of such ventures. Usually this is the case, although subscriptions are very often given in inverse ratio to results received.

Ultimate Benefits. In the third place, subscriptions and donations which will ultimately help the community and also business are chargeable partially to personal account and partially to the cost of doing business. This is logical because anything that makes the community more attractive residentially should enlist the support of every citizen regardless of his calling. On the other hand, the fact must not be overlooked that a man in business is much more dependent upon the community's success than are other men in the same community. Because of this larger interest and the attendant risk, the merchant is justified in calling part of his expenditures for community welfare a cost of doing business, provided these expenditures are larger than those of persons with equal paying ability who are not in business.

Co-operative Donation.—In some towns requests for subscriptions and donations have become so numerous, and for enterprises of such doubtful validity, that some special co-operative effort in combating this evil has been necessary because one merchant alone can seldom afford to refuse to subscribe and risk incurring displeasure and ill will. This co-operative effort has usually taken the form of a committee appointed by the merchants, which passes on any requests for subscriptions or donations before any merchant agrees to subscribe or donate. This method enables merchants to do collectively what it is impossible for them to do individually because of competition, and cuts down an expense which had become burdensome. It likewise does away with many fraudulent schemes which seem to be able to get a hearing in any community in which certain individuals are without a reasonably developed sense of responsibility.

Taxes and Insurance.—The items taxes and insurance may be kept separate for analysis, but they are often combined for convenience. Taxes on fixtures, stock, and the like, are more or less fixed in character and are beyond the control of the merchant. Usually he experiences greater difficulty in cutting down this item than in cutting down the items previously enumerated in the cost of doing business. Insurance (fire, plate glass, burglar, etc.), on the other hand, has often been cut down by making the insured property a better risk. Sometimes a talk with the insurance agent will be productive of suggestions that will make a decrease possible. After one such talk, a certain merchant cleared up a heap of boxes, barrels, and rubbish near a shed at the rear of his store, and as a result reduced his fire insurance premium by 15 per cent. One store found that it could pay for a sprinkler system in five years through reduced premiums directly resulting from the installation of such a system. In this case, after the five-year period, the reduced premiums will be a net gain, and a large one.

Stolen Goods.—The amount of goods on hand at the beginning of any period, plus the purchases during that period, minus the sales, gives the amount of goods on hand. A physical inventory will reveal whether or not the amount that should be on hand is actually on hand. If it is not, the difference between the estimated stock and the actual stock should be written off the books as a loss and charged to the cost of doing business. Perhaps the goods have been stolen by the salespeople, perhaps by the customers, or they may have been lost; whatever the cause, the loss is a legitimate cost of doing business and should be borne by the customer in the mark-up.

Thefts Committed by Customers.—The stolen goods problem is difficult to solve, especially in some of the larger stores

where the crowds are dense and shoppers carry handbags. In one store, the situation became so bad that it was necessary to deny customers who carried handbags entrance to the store. In another store, the expensive cut glass was finally locked up in a special glass-room in the middle of the floor where formerly it had been displayed on open tables. By employing detectives and other protective measures, stealing has been reduced but not eliminated. Indeed, it is a question whether a store should try to eliminate it, because of the means which would have to be adopted to overcome it. Open displays would give way to displays behind glass, thereby eliminating theft but likewise reducing the volume of sales; close surveillance of each customer would have to be practiced, thus antagonizing many honest people; and other methods would have to be adopted which would be disadvantageous in competition with other stores where supervision and methods of reducing theft were not so rigid. The most satisfactory policy is to eliminate the most obvious theft and charge the balance to the cost of doing business. The frailty of human nature is one of the conditions that the store has to meet, just as it submits to the irregularities of weather. Coal and electric fans are provided to meet the varying weather conditions successfully. In the case of the store, some goods must be sacrificed in order not to antagonize those who are beyond suspicion.

Thefts Committed by Salespeople.—Where thefts are committed by salespeople devices have been arranged to prevent them. One of the most successful of these devices is the inspector's label. When goods are purchased by the salesperson, the inspector's label is pasted on the package when it is wrapped. No parcel is allowed to be carried out of the store unless it bears this label. Of course it is possible for a salesperson to secrete some article in a coat pocket or a muff, but if these smaller articles are consistently missing

when the estimated stock is checked up with the physical inventory, suspicion will be cast on the salesperson. That it is possible to steal small articles here and there in the department through the year without much fear of detection, no one will deny. All that a store can hope to do is to eliminate a large part of the theft.

It is sometimes a delicate matter to install an inspection system in a store where salespeople have been in the habit of carrying out unidentified packages whenever they desired. The only hope of success has been to show that such a system protects the honest salesperson. Without some such scheme suspicion may fall where it is least deserved, while the store can justly be condemned for throwing temptation before the weaker members of the selling force. To ascertain the salesperson's point of view in regard to such a system, is to insure its working successfully. To attempt to install it arbitrarily, is to court disaster.

Inventories.—In order to prevent gross dishonesty it is necessary to take inventories several times a year. Some stores have a department inventory every month, others every two months, still others every quarter or half year. One inventory a year is inadequate, not only because of the defective analysis that inevitably results, but because of the attendant impossibility of discovering stock or money discrepancies before it is too late to run down the source of the trouble. It offers a loophole for dishonestly inclined salespeople, whereas frequent checking up between stock and sales insures prompt discovery of loss and an increased possibility of placing the blame.

Ingenious Methods of Stealing Cash.—It may be thought that the method of identifying packages through inspection will largely prevent theft by salespeople. It will go far toward

eliminating the theft of stock, but not of money. There are many ingenious ways in which large amounts of money have been stolen from different departments. In a department store, over $700 was stolen in nine months in the trunk department before the discrepancy in money between stock and sales was discovered. This theft on such a large scale was accomplished by a method which is suggestive of the possibilities in this direction.

Suppose a customer purchases a traveling bag at $15 and a trunk strap at $3.50. When asked if he will have the purchases sent, the customer says that he will take his purchases with him, and as the salesman begins to enter the transaction in his duplicate sales books, the customer lays a $20-bill on the counter. The salesman then gives the customer a duplicate slip correctly made out and totaled, while the money is wrapped in the original sales check and sent to the cash girl by means of a carrier or tube. The carrier returns the cash receptacle, the salesman opens it, takes out $1.50 and gives it to the customer, who thereupon takes the merchandise and leaves the store. This transaction appears to be perfectly honest, yet after the customer has gone, the salesman walks back to the cash receptacle, takes out $15 and puts it in his pocket. How does it happen that $15 comes back in the cash receptacle? In this particular case the salesperson had inserted a steel point in the socket on the rubber end of his pencil. While he was apparently recording the first purchase, he was merely tracing the letters with the steel point on the original. The point, however, was writing the item on the duplicate because of the carbon. He took the lead end of the pencil and recorded on the original the sale of the strap. Then with the steel end he totaled the transaction. Only one item—the strap—appeared on the original sales check, while on the duplicate appeared a correct record of the sale.

Many equally ingenious methods for stealing cash have

been uncovered, and all have existed where either infrequent inventories were taken or where these inventories were haphazard and inaccurate in character. If salespeople feel that there is a methodical, frequent checking up of goods and sales, a great moral force is created which increases their selling efficiency by removing temptation. It also prevents loss which may seriously reduce profits and handicap the ability of the store to serve the public.

Fuel, Light, Power, and Ice.—As with other combined items of the cost of doing business, it may at times be advisable to keep the items fuel, light, power, and ice separate for purposes of analysis. In regard to the first item there is much waste at present because of ignorance of quality of coal. Coal is usually purchased at so much a ton, sometimes the cheaper coal being purchased in the hope of saving money. Since coal is valuable, however, only from the standpoint of what it can accomplish—thermal heat units—sometimes the cheaper coal is actually the more expensive to use. A study of the content of different grades of coal available for use in any community will be productive of a saving in this item of the cost of doing business.

In regard to the second item, to get the maximum light and the right quality of light with the minimum of expense is the problem that every merchant faces, whether or not he solves it. To be certain that this item is no larger or smaller than it should be, there should always be some means of obtaining accurate information in regard to the different systems of lighting, as well as the relative efficiency of each for the purposes to which they are put. Thousands of dollars are lost in most communities every year because of inefficient store-lighting systems. This loss does not merely include wasted light, but also lost trade. The efficient lighting system costs no more than the inefficient one, because if a commodity

is needed for efficiency's sake, it is paid for, whether purchased or not. The two remaining items in the classification are self-explanatory.

Telegraph and Telephone.—Sales can often be increased by installing more telegraph and telephone equipment. An adequate telephone service is necessary in stores, and especially grocery stores, some of which have one phone when they could advantageously use two or possibly three. To call up a store time after time and find it "busy," exasperates customers and diverts trade to those stores that have prompt service; and prompt service from salespeople is no more necessary than is prompt telephone service, yet the latter is more often overlooked than the former. Seldom is telephone expense too large; usually it is too small.

The same may be said regarding telegraph expense. To order goods by mail instead of by telegraph when the merchandise is needed quickly, indicates a failure to render the prompt service that a customer desires. The new merchandising lays emphasis on smaller stocks and quicker turnover, so that as one garment is sold another may be ordered. Ordering by telegraph and shipping by express increases the cost of the items, but this does not make necessary a higher mark-up. Since there will be less mark-down due to dead stock, the mark-up in the first place does not have to be as large as would otherwise be the case. The price of the merchandise to the consumer is therefore actually lower although larger expense for telegraph and express is incurred. Of course the increase in the cost of these items can be carried to an extreme, but generally speaking, fewer mark-downs mean a lower average mark-up.

Express, Freight, and Drayage.—Some stores add these items to the cost of doing business but it is better to include

them as part of the original cost of the goods and not as an expense. This procedure would appear to be logical, because the cost of doing business does not commence until the goods are in the store. The goods are not "produced" so far as the store is concerned until they have been placed in the warehouse or delivered to the store. Their mere existence in New York or Chicago, or elsewhere, has no meaning to the store. So far as the store is concerned they do not exist. They come into existence only when they are delivered. Then and then only the selling expense begins.

Cost of Doing Business.—Finding the selling price implies finding first the cost of doing business. This can be stated in dollars and cents as a total of all of the individual costs above referred to, or it can be represented by a percentage of the gross sales. The cost of doing business is usually stated in terms of a percentage, which is secured by dividing the total expense by the gross sales. Thus, if the gross sales amounted to $60,000 and the total expense $12,000, the latter figure divided by the former gives 20 per cent as the percentage cost of doing business.

Finding the Selling Price.—In the process of figuring the selling price, the mistake is frequently made of estimating the cost of doing business as a certain percentage of the gross sales, and adding this percentage to the cost price. In other words, it is not realized that a percentage of the gross sales is more than the same percentage of the invoice cost. To illustrate: If the cost of doing business is 20 per cent of the sales price, this would amount to 25 per cent of the cost price. That is, it would be necessary to add to the invoice cost 25 per cent of the purchase price to realize the cost of doing business which has been stated as 20 per cent of the sales price. If the cost of doing business is 25

per cent, in order to realize this percentage on each sale, 33⅓ per cent of the invoice cost of each article would have to be added to the original cost of the goods.

A Hardware Merchant's Experience. The failure to make a profit has frequently resulted from the failure to understand this problem. One author[1] reports that for a certain hardware merchant the cost of doing business was 18 per cent of sales. In fixing the price of an article on which there was competition, 18 per cent and 10 per cent of the cost price were added for the cost of doing business and for profit respectively. This net profit of 10 per cent appeared attractive on paper, but it never appeared in any other form. It did not exist. The trouble was that while the real cost of doing business was 18 per cent on sales, it was more than this percentage on cost. The impossibility of making this profit under such circumstances is seen from an analysis of a hypothetical sale. If an article cost $1, and 28 per cent was added for the cost of doing business and for net profit, it sold for $1.28. Now 18 per cent of this selling price, or 23 cents, must meet the cost of doing business, leaving a balance of $1.05. Out of this amount must come the original cost, or $1, leaving a net profit of 5 per cent of the cost price instead of 10 per cent as was expected.

This hardware merchant handled a stove the wholesale price of which was $9.25, with a freight and cartage expense of 75 cents, making the stove cost $10 when delivered at the store. This stove was handled also by a competitor, so it was decided to cut the profit to 10 per cent net. To the cost price, 18 per cent was added for cost of doing business and 10 per cent for profit, making the stove sell at $12.80. On this basis the merchant thought that he was making a profit of $1. That he was not making this profit is shown by the

[1] A. M. Burroughs, A Better Day's Profits, pp. 45-52, Detroit, Burroughs Adding Machine Co., 1912.

following analysis: If the article cost $10 and a gross profit of 28 per cent was desired, the selling price should have been considered as 100 per cent and the cost price as 72 per cent, or all of the 100 per cent except the gross profit of 28 per cent. The correct selling price which would have returned a gross profit of 28 per cent is secured by dividing $10 (the cost in money) by .72 (the cost price in percentage). The quotient, $13.89 should have been the price of the stove, since any smaller sum than this would make the desired profit unattainable. This can be proved by the following process: 28 per cent of $13.89 is $3.8892, or the gross profit. This sum subtracted from the selling price, or $13.89, leaves $10, or the original cost price. Thus it is seen that the selling price of the stove should have been at least $1.09 higher than it was in order to return a profit of 10 per cent, together with the 18 per cent cost of doing business.

Profit Lost by a Grocer. Another case is cited by the same writer:[2] A grocer reported to a banker that he had made $2,000 profit on his yearly sales of $20,000, but analysis showed a large discrepancy between the supposed profit and the actual profit. This grocer's cost of doing business was $4,600, or 23 per cent, and he figured for 10 per cent net profit. During the year, $15,000 worth of goods had been marked up 33 per cent, making the total sales equal approximately $20,000. Now, in seeking to locate the profit, 33 per cent of $20,000, or $6,600, was taken out to cover profit and cost of doing business, leaving a balance of $13,400 to pay for the goods. But the goods cost $15,000, hence $1,600 of the supposed profits had to go toward paying the balance of the cost of the goods. This left a real net profit of $400, or 2 per cent on $20,000.

Effect on Mark-Down. To change the base of figuring is

[2] A. M. Burroughs, A Better Day's Profits, Detroit, Burroughs Adding Machine Co., 1912.

dangerous, not only in marking up but also in marking down. A clothier who figured for 30 per cent net profit planned a special "25 per cent off" sale. He thought that he would still make 5 per cent, and could afford to sacrifice part of his profit for advertising purposes. Suits previously selling for $20 were reduced 25 per cent, or marked down to $15. These suits cost $13.50, while 20 per cent for cost of doing business and 30 per cent for profit were added to the cost of the suits, making the selling price a little over $20. The 20 per cent cost of doing business on the original marked price ($20) amounts to $4, which, added to the cost price of $13.50, gives $17.50. Therefore, on each suit that was sold at $15, a loss of $2.50 was incurred. During the sale $3,000 worth of clothing was disposed of at a loss of $500, instead of at a profit of 5 per cent, or $150, as was supposed. This merchant was all right as long as he was adding 50 per cent to his cost price, although he was getting less profit than he thought he was getting, but when he began to cut prices he was figuring from an unsound basis.

Illogical Basis for Figuring Percentage Mark-Up.—There is nothing inherently wrong in using the invoice cost as the basis for figuring the percentage mark-up. The trouble is that many merchants forget that an amount represented by a percentage of the cost of the merchandise is less than that represented by the same percentage of the price thus marked. Adding a per cent to the invoice cost of merchandise allows this per cent on what is paid for the merchandise, but not this per cent of every dollar's worth of merchandise sold.

There are several reasons why it is illogical and inconvenient to use the invoice cost as the basis for figuring mark-up percentages: [3]

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[3] T. A. Fernley, The Right Way to Figure Profits, p. 28, Detroit, Burroughs Adding Machine Co., 1914.

1. The remuneration of salesmen is figured on a certain percentage of the selling price.

2. The percentage of expense of conducting business is based on the selling price. If one talks about per cent of profit on cost and per cent of expense on the selling price, confusion results.

3. The sales totals are always given in books of records; cost totals are seldom if ever shown.

4. Mercantile and other taxes are invariably based on a percentage of the gross sales.

5. A profit must be provided for two items of capital: one the capital invested in merchandise, the other the capital necessary for operating expenses and other expenditures not properly chargeable to merchandise account. This is possible only by figuring profits on the selling price.

6. It does not indicate correctly the amount of gross or net profits. Only the percentage of profits on sales can indicate the result of the year's business.

7. Allowances in percentage to customers are always from the selling price.

8. No profit is made until the sale is actually effected.

9. Nine stores out of ten which do not figure on the selling price get mixed somewhere in their figures.

10. The chain stores and the large stores always figure on the selling price.

CHAPTER XIX

MARKETING AGRICULTURAL PRODUCTS

Similarity to Marketing of Manufactured Products.—The problems of marketing agricultural products differ from those involved in marketing manufactured products in that the marketing machinery is much more complicated and the emphasis placed on certain marketing functions is different. The persistence of a seller's market for agricultural products has served to retain a longer series of middlemen than is found in the market mechanism for manufactured products. The nature of agricultural products gives rise also to peculiar transportation problems, different methods of buying and selling, assuming risks, financing, storing, and grading. The rôle of the government in marketing each class of commodities is likewise somewhat different, greater governmental supervision being exercised over agricultural products.

Grading.—With the widening of markets the need for standard grades becomes imperative, for unless standard grades are established, the time and effort incident to inspection by the buyer become increasingly great with the increase in the size of the market and slow up the marketing process with a consequent increase in marketing costs. Grading thus increases the marketability of a commodity. This principle of marketing is illustrated by the preference shown in New York for Washington apples as compared with western New York apples. The former are packed in boxes and classified into standard grades, the character of which does not vary in any container, or from season to season; the latter are

packed in barrels, the size, shape, and color of the apples varying in different parts of the barrel and from season to season. Nebraska potatoes are as good potatoes as those of Michigan, but they are not as marketable because they are not graded so well. The price the farmer receives for eggs is usually less if they are not graded, and if each case contains large and small eggs, brown and white eggs, dirty and clean eggs, fertilized and non-fertilized eggs. The risk of handling such a heterogeneous product is greatly enhanced by lack of grading, and is exhibited in the larger middleman margin.

Grading also renders other services in the market:

1. It is forcing producers and shippers to give up dishonest methods of packing which have been common in the marketing of fruit, hay, and grain. Standard grades have also stimulated the advent of standard containers.
2. Future contracts in organized exchanges are made possible because they run "on grade."
3. A standard grade furnishes a basis for a standard price.

The latter two market services are closely related. When a future contract is made on a basic grade, such as No. 1 Northern Spring wheat, it is not understood that this grade must be delivered but that the price quoted is based on this grade. If a grade above or below this base is delivered, price adjustments will be made according to a fixed schedule in the case of wheat, while in the case of cotton a price adjustment is made according to commercial differences, or differences determined by actual market transactions. In either case, grading stabilizes price and facilitates price quotations to the advantage of buyer and seller.

Difficulties of Grading.—Some commodities are more adaptable to grading than others. Manufactured machine-made

goods can be graded with absolute accuracy. Agricultural products can only approximate this ideal. Perishable commodities are more difficult to grade than the non-perishable because of the greater haste required in marketing. Some agricultural products vary in size more than others, thereby increasing the difficulty of grading. For example, kernels of grain do not vary as appreciably in size as do apples, eggs, and potatoes. Moreover, the same kind of commodity may vary in size from season to season so that a grade may come to have different meanings. This applies to apples, pears, and citrus fruits. Grading is further impeded by the fact that some products have not the same values for different buyers. For this reason barley cannot be graded as accurately as wheat. In such cases, where universal standards of grading are difficult to accomplish, growers, either individually or co-operatively, may increase the marketability of their products by establishing a reputation for consistent grading.

Storage.—The function of storage, or warehousing, is to effect a time adjustment between production and consumption. The fact that agricultural products are produced at a time not contemporaneous with demand makes it necessary that the surplus portion of the crop be stored and "eased out" on the market as the demand increases sufficiently to absorb it. If $^1/_{52}$ of the egg crop came on the market each week there would be no necessity for warehousing, known as cold storage. The warehouse is also necessary in the marketing of manufactured products for which there is a seasonal demand and a seasonal supply. If the demand for agricultural implements varied between narrow limits from week to week large warehouses for machinery and parts would not be needed.

It is the lack of adjustment between demand and supply in our present economic order that creates marketing prob-

lems. In the marketing of manufactured products this lack of adjustment expresses itself in the large potential supply made possible by capacities of plants, a supply which does not necessarily have to be produced unless a demand is created for it. In the case of agricultural products, however, the supply is created seasonally and must be cared for regardless of the existing demand. Storage is therefore a more important function from this standpoint in the marketing of agricultural products than is true of manufactured goods.

Transportation.—The perishability of one class of agricultural products—produce—has caused an important marketing problem, namely, the adjustment between demand and supply. Producing areas are often far removed from areas of consumption, thereby placing the burden of accurate coincidence upon transportation facilities. When a fruit crop like Georgia peaches matures, the problem of avoiding a glut at the point of destination is a great one. The crop must be rushed to market immediately and a market must be chosen.

Suppose Chicago is chosen as the market: A commission house in that city is notified of the shipment and the shipper awaits his returns. If a relatively large number of shippers have chosen Chicago as their market a glut exists, and the returns may not pay the freight. It is then that newspaper stories abound of fruit being dumped into the river while children go hungry. The producer's entire year's income may depend on the profitable marketing of that shipment, as well as the interest on the orchard investment during the years when the trees were not bearing. Such a marketing system discourages production, and by cutting down the supply of fruit, raises its price to consumers.

Refrigerator Cars.—Such were the dangers of shipping fruit until the introduction of refrigerator cars during the late

seventies. As a result of this invention, production of fruit and berries in the South for northern markets was stimulated and prices for these products fell. It was still true that perishable goods could not be kept for any great length of time even under refrigeration, as the latter costs are heavy. But refrigeration permitted in some cases the reshipping of fruits to markets more favorable, as well as preventing the former wastage en route to the first market. The growing privilege of diversion of carloads in transit, coupled with refrigeration, is tending to effect a nice adjustment between producing and consuming areas. Marketing machinery can be considered efficient only when it succeeds in making an efficient adjustment between supply and demand.

Problem of Ownership.—The introduction of the refrigerator car has brought forward the problem of ownership. The first refrigerator cars were privately owned, and the railroads have been loath to build their own cars in competition. This reluctance on the part of the railroads has been due to their belief that competing refrigerator cars could not be run at a profit. High depreciation and icing charges, as well as the seasonal nature of the demand for them, causes the operation of these cars to be attended with large risks. Within recent years, however, some of the railroads have commenced the operation of their own refrigerator cars.

Some evidence points to a producer's preference for the privately owned car, with exclusive contracts over the railroads through their districts. It is asserted that the privately owned car is cleaner, in better condition, and more prompt in appearing when needed than are the railroad-owned cars. For this superior service a higher rate is charged, and producers in some districts at least seem willing to pay this rate for the assurance that they will be adequately taken care of. On the other hand, opponents to the privately owned car maintain

that monopoly rights over any producing area result in indifferent service coupled with high rates. No doubt both views have evidence to support them in different districts. It seems that with the increasing tendency toward integration, the railroads must sooner or later take over the ownership and operation of this vital marketing device.

Need of Market Information.—It must not be supposed, however, that an entirely satisfactory market adjustment was made possible by the advent of the refrigerator car. In periods of bountiful production there is still much loss to producers. Perhaps the only remedy for such loss is better information as to the nature of the different markets. At the present time, market information as regards perishable commodities is meager and often unreliable, because it does not reflect rapidly enough changing conditions of supply and demand in different markets. Private agencies seem thus far unable to provide prompt and comprehensive information to producers which would enable them to choose their markets with greater prospects of finding a profitable selling price. It may be necessary for the government to take over this market function. If the government could provide a market information service as adequate and reliable as its crop reports, there should be little hesitation among market functionaries in seeking such a solution.

Effect of Rates on Markets.—Transportation is the chief factor regulating the size of markets. If it is swift, efficient, adequate, and economical in the handling of agricultural products, and if rates are equitable, producing areas may be far removed from areas of consumption. As a consequence commodities may be produced at the lowest costs in those areas best fitted naturally and otherwise for their production. In other words, geographical division of labor is dependent upon

the transportation system. A chief reason why rate-making is extremely important is the fact that rates enter into costs and costs into prices. If the cost of a certain commodity from one section of the country is higher than that of a similar commodity from another section of the country, the former commodity is at a disadvantage in competing with the latter. Hence it is seen that rates determine the size of the market and limit or extend the competition of similar commodities.

Because of this relation of rate-making to marketing, rate determination has received much serious consideration, and elaborate rate schedules have been formulated with the purpose of developing industries and territories that are of greatest social and economic concern. As a consequence of this policy, some markets have been developed at the expense of others, goods have been transported below cost, the natural advantage possessed by waterways has been neutralized, the competition of substitute commodities has been minimized, and the competition of similar commodities has been intensified. For example, the rate east on western apples is so low that New York apples do not have the advantage in that state and its surrounding territory that one might imagine.

In this particular instance the market for one product has been contracted, while the market for a similar commodity has expanded enormously. In New England, competition between mills and factories is equalized by fixing a flat rate for all the raw materials, such as coal, wool, cotton, etc., imported into the district, while the rate on outgoing manufactured goods is the same from any part of the district. In other geographical districts the basis for rates differs, the purpose of rate-making always being to develop markets economically by using the natural resources of a district to meet most adequately the needs of its population and its industries.

Financing.—To a large degree agricultural products finance themselves. Loans are made on growing crops by means of mortgage instruments. The producer generally gets cash for his grain from the local elevator, but the stored grain usually serves as collateral for a loan out of which the cash payment is made. Such a loan may be advanced by a local bank, or by a bank in the central market, through the medium of a commission man or other middleman. When the grain is shipped, its bill of lading is the basis for another loan. The final place of deposit of the grain is a terminal elevator where it awaits export, shipment to another domestic market, or shipment to a miller. The warehouse receipt representing the stored grain is collateral for a final loan, in order to consummate this last step in the marketing process. From the producer to the wholesaler, and from point to point on the way to the consumer, the burden of financing the marketing of grain is borne by the product itself.

It is not believed that this is the proper place for a descriptive analysis of the different credit instruments used in financing the marketing of agricultural products. It is enough to understand that the usual method of financing the shipper is effected by the commission man or wholesaler, one or the other of whom permits the shipper to draw a draft on him covering the larger part of the value of the product at the time of shipment. The shipper obtains his money by discounting this draft at a bank at the point of shipment, turning over to the bank the bill of lading. The draft and the bill of lading are sent to the consignee, who pays the draft and when the shipment is sold makes settlement with the shipper for the balance. Where this method is not followed shippers may run open accounts, making collections periodically; or the product may be sold at auction, the auction company making returns when the product is sold. Whichever method of sale is pursued, the banking system facilitates the marketing

of products by extending credit to the different market functionaries at each point in the marketing process.

Market News.—Market news is the essence of market price. It is through the agency of market news that supply and demand conditions are resolved into terms of price by both sellers and buyers. Market news not only serves to focus price-fixing conditions; it also is one of the means of determining the size of the market.

A world-wide market for wheat has developed because men all over the world buy and sell on the basis of the same knowledge (market news) and are able to make their buying and selling effective through modern methods of transportation. Market news is thus a dynamic, directive force in the marketing mechanism.

Because this force is actively engaged in the vital process of price determination, its generation and modes of application are of great significance to the consumer. Market news is secured and issued by two classes of organizations, viz., public and private. The chief public organization is the Bureau of Crop Estimates in the Department of Agriculture, although much valuable trade information issues from the Census Office, the Bureau of Foreign and Domestic Commerce, and reports issued by bureaus in the different states. Private sources of market news are: trade journals, brokerage houses, exchanges, market news agencies, trade organizations, and commission houses.

Function of Large Speculative Transactions.—Large speculative transactions perform a very important marketing function. They create a continuous market, i.e., one in which it is possible to buy and sell at all times. The significance of this possibility lies largely in the fact that dealers may sell short or buy long for the sole purpose of securing profits from

fluctuations of price. The performance of this function makes possible another; for if it were not for this extensive buying and selling, the future market could not be used so effectively by dealers in connection with what is known as hedging, the purpose of which is to avoid the risks of price fluctuation. Since this latter use of the future market depends on the former use, speculation may be thought of in terms of its chief function, viz., hedging. As developed below, speculation has also other functions closely allied with hedging.

Hedging.—Hedging may be explained by an illustration. A Chicago grain dealer is accustomed to make a trade profit by buying grain and finding purchasers for it on the eastern seaboard. In September he purchases 50,000 bushels of wheat for $1.65 a bushel and puts it in store, waiting for a purchaser. In the meantime, if the cash price rises to $1.66 he makes a speculative profit of one cent per bushel; if the price falls to $1.64 he loses one cent. In order to avoid this risk of profit and loss through price fluctuation, at the time the dealer makes his cash purchase he sells a contract for the delivery of wheat in October (an October future), for the same number of bushels at a price of $1.65½. The extra half cent represents the cost of carrying the grain for a month, or until he finds a purchaser.

In the event that the price of cash grain rises to $1.66 by the time a purchaser is found (the future will rise approximately by the same amount, i.e., to $1.66½), the dealer will make a speculative profit of one cent on his grain in store but he will lose one cent on his future contract, since he sold the future at $1.65½ and must now go into the future[1] market and purchase at $1.66½ in order to cover.

[1] Of course, if he found a purchaser for his wheat on the same day that delivery under his future contract was due, he would not need to buy a future but could buy grain at the lower spot rate. Rarely, however, would the two dates coincide.

Hence, if the price rises the dealer neither loses nor gains, because what he gains on his cash wheat he loses on his future wheat.

The transaction may be illustrated as follows:

Purchases		Sales	
Cash at	$1.65	Future at	$1.65½
Future at	1.66½	Cash at	1.66
Totals	$3.31½	Totals	$3.31½

If price falls to $1.64, the dealer will lose 1 cent on cash grain, because if he had waited he could have purchased it for $1.64 instead of $1.65. On the other hand, the dealer will make a speculative profit of 1 cent on his future contract, because he has contracted to sell at $1.65½ and he can go out into the market and secure wheat at $1.64½ to cover his future contract. Hence, what he loses on his cash grain he makes on his future contract.

The transaction may be represented as follows:

Purchases		Sales	
Cash at	$1.65	Future at	$1.65½
Future at	1.64½	Cash at	1.64
Totals	$3.29½	Totals	$3.29½

The gains offset the losses; the risk of price fluctuations is shifted to the shoulders of the speculator. Because of the existence of a speculative market in wheat futures, the dealer has been enabled to eliminate from his calculations the possibility of losses (as well as gains) due to market fluctuations.

The dealer desires to make trade profits, not speculative profits, hence he hedges. Hedging, however, does not always

completely insure trade profits. It all depends upon the spread between the cash and future prices. In the illustration just cited it is assumed that the future price fluctuates with the cash price, a situation which is approximately correct over short periods of time. As the maturity of the future contract approaches, the spread between the cash and future prices narrows. In the first illustration, if the spread had narrowed the dealer would have made a profit from the hedging transaction; if it had widened he would have suffered a loss. The future price should bear a definite relation to the cash price, represented by the carrying charges. If the future price ceases to fluctuate parallel to cash prices, perfect insurance of trade profits is impossible; yet the risk of loss or gain, even in such cases, is small compared with fluctuations in the price of the commodity itself.

Hedging without the Speculator.—Theoretically, speculation is not necessary for hedging. For example, a terminal elevator purchases 10,000 bushels of wheat at $1.87 on November 11, and at the same time desires to hedge this purchase by the sale of a December future for the same amount at a price of $1.87 plus the carrying charges of ½ cent, or at a total of $1.87½. On the same day a miller has sold his entire December output of flour, for which 10,000 bushels of wheat are required, at a price based on the price of wheat November 11. As the miller will not need the wheat until December, he is desirous of purchasing a December future for 10,000 bushels at a price of $1.87½. If the terminal elevator representative can meet the representative of the miller, the former can sell to the latter a December future for 10,000 bushels at a price of $1.87½, and both parties to the transaction will have received market insurance.

Without an abundance of speculators, however, hedging would, in actual practice, be difficult. For example, the ter-

minal elevator might desire to sell a December future for 10,000 bushels at a price of $1.87½, while the miller might desire to purchase a May future for 8,000 bushels at a price of $1.90. Such a lack of coincidence between the buyer's demands and the seller's offers would necessitate seeking out traders who had exactly what was desired by the purchaser or the vendor. This market friction would retard a quick placing of hedges and increase the risk involved in handling grain. With the increase in risk involved, the middleman's margin would of necessity have to be increased, which ultimately means a lowering of the price paid to the producer. Without numerous speculators who are ever ready to buy and sell, the placing of hedges would be handicapped to the same extent that present-day commerce would be retarded by a system of barter instead of money and credit.

CHAPTER XX

MARKETING AGRICULTURAL PRODUCTS—TENDENCIES TOWARD INTEGRATION

Buyer's Market versus Seller's Market.—A chief question with reference to the marketing of farm products is whether the manner of present distribution through the various functionaries is substantially satisfactory, or is likely to be radically changed in the direction of greater integration.

At the outset it should be noted that whether or not the marketing functions in the distribution of agricultural products tend toward integration or toward differentiation depends on whether a buyer's or a seller's market prevails. If agricultural products can be produced at decreasing costs, integration is stimulated, while production under increasing costs means differentiation. When increasing costs prevail, supply becomes relatively scarcer than demand. Prices are high, the producer is satisfied, and his time and energy are expended not so much in simplifying, shortening, or integrating the marketing system as in attempting to increase his production. Such has been the situation in agriculture, with a few minor exceptions, until the present time. Such also was the condition during the nineteenth century in the field of manufacturing. When decreasing costs prevail, however, supply becomes relatively more plentiful than demand. Prices are low, the producer is dissatisfied, and an increasing amount of his time and energy is expended in closely scrutinizing the marketing system.

During 1920-1921 the agricultural industry was in this situation. A buyer's market prevailed and schemes of inte-

gration were prolific. It is extremely doubtful, however, whether a buyer's market in agricultural products will continue for any length of time. Unlike manufacturing, the producing plant in agriculture is limited by nature. That population is already increasing at a faster rate than the production of agricultural products is evidenced by the rapid increase in wholesale prices of these products during the last generation in comparison with the wholesale price of manufactured commodities. Only temporary conditions, such as a bumper crop and the closing of export markets due to lack of credits, have thrown the agricultural industry into a buyer's market.

Present Tendencies—Abuses and Their Correction.—Certain orchard products are apparently being produced at present under decreasing costs. With respect to these products, accordingly, the emphasis which was formerly placed on production is now being laid on marketing. Co-operative growers' associations, such as the California Fruit Growers' Association, are controlling more parts of the marketing mechanism and are shipping direct to representatives of their own associations. In the grain trade, if certain existing abuses are not eliminated by those organizations that have the industry under control, a similar movement may be expected soon to develop.

Until within the last few years strings of elevators along any one railroad were in the hands of a single corporation. The producer was at the mercy of the monopoly, as regards the price that was paid for his grain and the determination of its grade. The abuse of this power was mitigated by establishing farmers' co-operative elevators throughout the Middle West. With that success the movement toward integration of marketing functions seemed for a time to have spent itself. Other abuses in the marketing system, however, have since

developed, and further integration has been checked only by the existence of a strong seller's market. Little more than the reversal of market conditions, i.e., the swinging of the agricultural industry into a buyer's market, is needed to make effective the potential opposition to some phases of the present marketing mechanism. It may be noted, however, that with respect to some of the abuses alleged, even if their existence is proved, the remedy lies not in integration but rather in regulation by law.

Grading.—Some of the alleged abuses concern the grading function. In the terminal markets a system of grading developed some time ago which, the producers believed, gave an advantage to the terminal elevators and millers. Producers have naturally felt that their grain should be graded higher than it usually is, whereas terminal elevators and millers have persisted in the belief that the grades given to grain are higher than is justifiable. Because of the suspicion attached to the grading that is performed by exchanges and private inspectors, several of the leading grain states have made that act a public function. This development has no doubt lessened the abuses that formerly existed, but dissatisfaction is still manifested even with the decisions of the state inspection boards. This fact is substantiated by the large number of appeals for reinspection in the state of Minnesota during 1912-1913. Reinspection was demanded in more than one-fourth of the cases, and 36 per cent of all reinspections resulted in changes of the original grades or dockage.[1] That the producer is justly suspicious of the grading system is evidenced by the fact that 23 per cent of all reinspections resulted in raising the grades, whereas only 6 per cent resulted in lowering them.[2]

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[1] L. D. H. Weld, The Marketing of Farm Products, pp. 373-374, New York, The Macmillan Co., 1916.

[2] *Ibid.*

Obviously, the remedy for any such inefficiency is not integration but federal standardization of grades and inspection of grain, such as has developed in the cotton-growing industry. In this industry the Department of Agriculture has fixed standards for nine grades of cotton, and sample specimens of the grades, in sealed tubes, are at the disposal of exchanges and serve as permanent standards. Their use is not compulsory, but exchanges have adopted them generally. Federal grades of corn have also been determined upon, and while not compulsory, they have been adopted by several state inspection departments and grain exchanges.

Storage.—Other alleged abuses concern the storage function. Many misconceptions exist regarding the functions which refrigerator cars, cold storage houses, grain elevators, tobacco warehouses, etc., perform. For example, storage is thought by some to be a device for creating an artificial scarcity with an attendant artificial high price. Especially has this charge been brought against cold storage. Public warehouses do not as a rule purchase goods in large quantities on their own account, but rent space to numerous dealers who own the commodities stored. Evidence seems to exist which indicates that prices of stored commodities are no higher over a long period of time than they would be without storage, although prices are higher at certain periods of surplus production and lower during periods of meager production. This is illustrated by the price of butter in New York, which varied from 21.9 cents to 34.3 cents per pound during the years before cold storage developed, while during the latter period the variation was from 23.4 cents to 28.9 cents.[3]

This stabilizing of price seems desirable because of the stimulating effect it has on production and consumption. Dur-

[3] L. D. H. Weld, The Marketing of Farm Products, p. 160, New York, The Macmillan Co., 1916.

ing periods of plentiful production less waste occurs to producers, because prices are high enough to enable profitable marketing of the commodity and hence a higher level of production is maintained, while during periods of low production prices do not rise so high that consumers must change their buying habits and cut down consumption. It therefore appears probable that long-time prices of commodities subject to storage would even be lower because of storage. Some little evidence exists in favor of this assumption as regards butter, eggs, and poultry.[4] It might appear that a lower price to the consumer means a lower price to the producer. This does not necessarily follow. Because of cold storage creating a ready and profitable market for perishable commodities during seasons of plentiful production, producers have been stimulated to large-scale activity. This new type of production operates at a lower per unit cost than was the case with the former type, and the lower producer's price is offset by the lower costs per unit of product. Lessening the risk incident to production usually increases production, with a greater profit to the producer, while lessening the risk incident to distribution usually narrows the margin demanded by middlemen and hence lowers the price which consumers have to pay.

It has been assumed by many people that storage injures the quality of products stored. Thus, storage eggs are supposed to have a "storage taste." Dr. Wiley is accredited with the statement, however, that fresh, unfertilized eggs placed in storage early in the season are at the end of eight months difficult to distinguish by taste alone from fresh-laid eggs.[5] It has been demonstrated that the condition of the product when placed in storage is a much more important considera-

[4] G. K. Holmes, Cold Storage and Prices, p. 65, U. S. Department of Agriculture, Bureau of Statistics, Bulletin No. 101, 1913.

[5] L. D. H. Weld, The Marketing of Farm Products, New York, The Macmillan Co., 1916.

tion as regards its quality than is the fact of reasonable storage itself.

In this instance, also, the remedy for whatever evil exists is not so much a matter of further integration of marketing functions as of government regulation. As better methods of producing and grading eggs develop, it is to be expected that some of the present complaints against cold storage will disappear. Yet, as it is no doubt true that too long a period of storage reduces quality, it is imperative that governmental authorities adequately regulate the cold storage business. Most states have made some advance in this direction and more adequate regulatory laws are now pending.

Commission Houses.—Abuses have been found also in connection with the work of commission houses. Producers have always been suspicious of the commission man. It has been natural for the shipper to be a "bull on the market." He ships when he thinks the market is going up, and consequently he often blames the commission man when the returns are not what he expected.

Unfortunately, this suspicion of the commission man has too often been justified, for, as a consequence of market evolution, the commission man in many cases has also become a jobber; he has purchased goods on his own account and has received them on a commission basis as well. Such a combination of functions has been prejudicial to the shipper's interests, because the commission man has been actuated by two motives diametrically opposed. On a bull market he would be led by self-interest to sell the commodity of his client and hold his own for a higher price, while on a bear market this situation would be reversed, the commission man seeking to sell his own commodity at the first opportunity and permitting his client's commodity to wait for the next opportunity.

As to whether integration may be expected in connection with the work of commission markets, surmise is difficult. No group has fought the abuses just mentioned more concertedly than the organized exchanges, a portion of the membership of which consists of commission men. Expulsion from the exchange has been the penalty for commission men who traded on their own account. This penalty has in some exchanges at least nearly exterminated the reprehensible practice. Yet the shipper has not forgotten the abuses of the past and is still often reluctant to use the commission man. Especially is this true in the perishable fruit trade, where producers have suffered such extreme losses that they have co-operated to keep their own representatives in the large wholesale receiving markets. If exchanges conserve the interests of all parties concerned in the sale of agricultural products, it will take an extremely strong buyer's market to endanger their position. On the other hand, if exchanges favor their own membership to the detriment of shippers and producers, only an extremely strong seller's market will prevent integration through unified effort of these latter classes.

Market Reports—Government Supervision.—In this connection it may be noted that increasing demand is being felt for public supervision of private market-reporting systems in industries where it seems inadvisable for the government to own facilities for securing and issuing market news. The accepted regulator of market price—competition—may be perverted by "inside information" if monopolized by a powerful private organization. This feeling exists regarding commodities which are generally sold by private sale, not those openly traded in on the exchanges.

Criticism has been directed especially against the type of market news known as price quotations, which have been used,

as a means of determining the price to be paid shippers. While such price quotations are supposed to reflect actual trading transactions, suspicion has attached to them because they are issued and controlled by middlemen to whose interest it is to underquote or overquote the market. Governmental supervision of the independent market reporting system would unquestionably tend to give producers confidence in price quotations.

Boards of Trade and Speculation.—The most widely discussed questions relating to the marketing of farm products have to do with the matter of speculation, and with the activities of exchanges and boards of trade. This is particularly the case in connection with the marketing of grain. During periods of low price, boards of trade have usually undergone close scrutiny by the producer. With the local elevators under the producer's control, with the government inspection and grading of grain, with the growing honesty and open methods of wholesale receivers and commission men, low prices for grains have been attributed to the machinations of exchanges and boards of trade.

The charges brought against the organized exchanges fall into two general groups, viz., those regarding cash sales, and those regarding sales of futures, or speculative sales. As the major part of the producer's disapproval is against speculative trading, this phase of the boards of trade's activities demands chief attention in considering the possibilities of further integration of the middlemen's functions in marketing grain.

Speculation and the Producer's Prices.—It is a charge frequently made that speculation depresses the prices paid to the producer. This charge is not based on fact. Instead of depressing the producer's prices, speculation raises them. A speculative market for futures enables country elevators, ter-

minal elevators, exporters, shippers, and other middlemen agencies to hedge their holdings, thereby reducing the risk of market fluctuations. With less risk a smaller margin of gross profit is necessary, and a smaller margin means higher prices to the producer. Country elevators are able to handle wheat at the low margin of three cents a bushel, because the risk of having this margin wiped out by market fluctuations has been largely eliminated by using the speculative market for hedging purposes. Double the present margin would perhaps be necessary if country elevators, and others handling grain from producer to manufacturer, were unable to shift the risk of market fluctuations to speculators. Evidence in favor of this assertion may be seen in the margin allowed on barley before the practice of hedging that commodity began. Five and six cents were the common margins that elevators allowed, and farmers received from two to three cents a bushel less for their grain because of the inability of the handlers to shift the risk of market fluctuations to the shoulders of speculators.

Speculation as Insurance.—As the losses of one class of speculators are offset by the gains of another, speculation pays for itself out of its own funds, not out of the price that a bushel of grain sells for. It is true, of course, that society as a whole pays the bill. The men and capital being used in speculation are withdrawn from other occupations, and hence what each would have produced in other occupations, is lost to society—that is to say, social resources are being used as an insurance fund. Insurance, however, is a productive industry because it prevents loss and thus stabilizes business. There is much confusion in the popular mind between speculation and gambling. The difference is that gambling creates its own risk while speculation merely assumes a risk which is already in existence. The gambler who turns a roulette wheel

brings into existence by his very act a risk of losing or winning. If he did not perform the act of turning the wheel, no risk of loss or gain could exist. The speculator, on the other hand, when he buys or sells a future contract, assumes the risk of market fluctuations which exist whether or not he chooses to shoulder them. He permits a producer, a miller, an elevator company, or an exporter to shift their risk of market fluctuations to himself. Or, as already suggested, the speculator becomes a sort of insurance agency which relieves market functionaries of an ever-present risk in handling grain.

Organized and Unorganized Speculation.—It should be borne in mind that speculation is woven into the fabric of commercial activity. In the case of grain, for example, the elimination of speculation in futures would in nowise eliminate speculation in grain. Changes in the market values of cash grain would still exist, and a purchaser of cash grain who held it for a rise would be speculating. When a house and lot are purchased, the purchaser is a speculator. The combined values may rise, remain stationary, or decline. The purchaser believes that they will rise, or at least that they will not fall. Herein he poses as a forecaster of changing market values and is therefore a speculator. During 1920-1921 the wheat farmers were induced by their leaders to hold their grain for a higher price. These farmers were speculators. As the price did not rise materially, they lost; but they would have been speculators just as much if the price had risen. They were speculators not because they lost or gained, but because they undertook to forecast market values. They could have been relieved of performing the function of the speculator only by buying futures against their cash sales. The function of forecasting the change in market values would then have been shifted to the shoulders of professional speculators.

The speculation referred to in the previous paragraph is unorganized speculation. It is not directed by rules known to the participants, nor are its operations exposed and clarified by publicity. Decisions to buy and sell are made on the basis of personal prejudice, hearsay, and snap judgment. Organized speculation on the other hand, as carried on in systematized exchanges, operates according to rules and regulations known to all participants. The function of providing grain insurance against market risks is performed in an orderly and economical manner by those qualified by experience to forecast changing market values.

Speculation and Price Fluctuations.—Rapid price fluctuations or market breaks are detrimental to business because a possibility of large losses develops timidity. Price stability develops market confidence which promotes further commercial activity. Strange to say, speculation has been accused of causing wide price fluctuations, and hence has been thought to depress business. The truth is that under normal conditions speculation stabilizes price, while lack of speculation permits an erratic market. That speculation stabilizes price is seen from the methods pursued by market operators. If the price goes up ⅛ of a cent the bulls, or longs, sell out and take their profit, and this liquidation tends to return price to its former level. On the other hand, if price falls ⅛ of a cent the bears, or shorts, buy in and fulfil their contracts, and this absorption of selling offers tends to return the price to its former level. Under normal conditions, with free and complete speculation, it is difficult for the market price to fluctuate widely because it is to the advantage of either longs or shorts to return it to its former position. Speculation thus produces market equilibrium.

A study of grain prices from 1899 to 1916 substantiates the position taken. It indicates that the price fluctuations in

those grains traded in on the future market were far less marked than was the case with grains for which no future market existed. Only once during this period did wheat show a fluctuation of over 100 per cent, and only twice did oats exhibit a fluctuation of this amount, while barley showed such a fluctuation eight times.[6] During a period of 100 years, before future trading was inaugurated, price fluctuations were twice as great as during the period since that date.[7]

Speculative Corners.—Speculation does not cause prices to fluctuate, but fluctuation in prices causes speculation. If all speculators were eliminated, prices would still fluctuate in response to the law of supply and demand. Some students of marketing wonder, however, if there would be such wide fluctuations as, for example, existed in December futures during the month of November, 1920.[8] In other words, some people agree that competition among speculators (bulls and bears) prevents wide swings of the market, but it is believed that combinations of speculators may so corner the future market that rapid price fluctuations will ensue when they choose to unload.

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[6] J. E. Boyle, Speculation and the Chicago Board of Trade, p. 123, New York, The Macmillan Co., 1920.

[7] *Ibid.*

[8] J. S. Ewart, *Lincoln State Journal,* Jan. 15, 1921.

December Option

Date	High	Low	Close	Range
Nov. 11	1.87	1.78½	1.80½	8½
" 12	1.80½	1.75	1.77¾	4½
" 13	1.83½	1.78½	1.79⅞	5
" 15	1.85¼	1.78¼	1.84	7
" 16	1.89¼	1.84¼	1.87⅝	5
" 17	1.90	1.82	1.84⅜	8
" 18	1.86	1.78¾	1.80¾	7
" 19	1.79½	1.71	1.72¼	8½
" 20	1.74	1.65¾	1.68¾	8¼
" 22	1.70	1.57½	1.60½	12½
" 23	1.69½	1.58½	1.68¾	11
" 24	1.67	1.58¾	1.59½	8¼
" 26	1.57½	1.52½	1.52¾	5
" 27	1.57½	1.53	1.55¾	5½
" 29	1.62	1.56	1.56½	6
" 30	1.58	1.54¾	1.56⅜	3¼

43½ cent fluctuation in 16 market days.

The answer to this belief is that market corners have at present little chance of success. In order to guard still further against their development, boards of trade have passed two very important regulations. One increased the range of grades deliverable on contract, and the other gave classification as "regular" to grain in elevators further removed from the center of the trade, as well as grain on track and grain in ships. With the widening of the character of the grain which could be delivered on a future contract and the extending of the source of supply of deliverable warehouse receipts, corners became practically impossible.

The wide price fluctuations in the fall of 1920 were caused in reality by the contraction of credit, a bumper crop, and lack of speculation. The tightening of credit forced producers and handlers of grain to liquidate their holdings, and the throwing of this grain on the market increased the existing overabundance caused by the largest crop of wheat and corn that had been produced for several years. The market was decidedly lopsided. It was predominently bearish and little buying took place, because of the almost limitless stocks waiting to be shipped to the terminal markets. Relief for this situation was sought by the leaders of farm organizations who counseled their members to hold their grain for a higher price. This tended to reduce the arrivals of cash grain, and to depress futures, because a season carry-over is generally impossible. It was believed that the greater part of the crop must of necessity come to the market in the spring, if not in the fall. A strange situation was thus created in which futures did not bear the usual relationship of carrying charges to cash prices, and in which complete hedging of trade profits became an impossibility. Instead of speculation causing the steep break, speculation was about the only force which could have steadied the market. Speculators are buyers as well as sellers. If there had been more speculators who had been

willing to buy wheat and corn as a result of forecasting the market, prices would not have fallen as quickly or as far as they did.

Transactions versus Actual Transfers.—That speculative transactions exceed grain transfers appears an abuse to some observers of market operations. This is illustrated by the following quotation: "Traders have no thought of delivering or accepting delivery, or of financing it, and 75 per cent of country traders could not finance one-fourth of the amount they trade in if the grain was forced upon them, yet it has been conservatively estimated that our crop of 3,216,000,000 bushels of corn has changed hands twice (some say three times) before a car-load was put on the market and the price fixed by men who never intended to merchandise a bushel of it." [9]

While the speculative transactions exceed the amount of grain that actually changes hands, they do not exceed the representations of actual grain that pass from one to another. The representations, or warehouse receipts, accompany all speculative sales in legitimate organized exchanges, and a transfer of a warehouse receipt is equivalent to a transfer of actual grain, although the physical grain is not moved in location. A trunk check may be transferred several times without the physical location of the trunk being altered, but the transfer of the check is nevertheless a transfer of the trunk itself—not in location but in ownership.

This excess of speculative transactions over actual physical transfers of grain is no different from the situation existing in our credit system. Future contracts are promises to pay grain, just as credit currency constitutes promises to pay money; and for the same reason that credit currency exceeds

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[9] J. S. Ewart, *Lincoln State Journal*, Jan. 15, 1921.

the amount of real money, future contracts exceed the amount of real grain.

The "future" market comprises two classes of speculators, professionals and amateurs. The professional makes a business of forecasting market conditions; he specializes in interpreting market phenomena. The amateur, on the other hand, is a lawyer, physician, teacher, preacher, laborer, clerk, or member of some other occupation, who dabbles in futures "on the side"—nine times out of ten with disastrous results. The amateurs operate, moreover, in very large degree through brokers or "private-wire houses" which in some cases are of doubtful integrity, or through bucket shops which are fake exchanges. It is unfortunately true that such fake exchanges, which are wholly illegal, still persist near some of the largest legitimate exchanges of the world, depending upon them in fact for market information. They are strictly parasites and should be eliminated. Much confusion in the public mind has existed because these fake trading centers have sometimes become identified in terminology with legitimate exchanges.

Remedial Forces—Education.—The abuses now existing in the great grain markets known as boards of trade or exchanges, may be remedied by a combination of three forces: education, the government, and the boards of trade themselves.

In regard to the first remedial force, people should be educated to understand the slight margin of success which the amateur has when in competition with the professional speculator. Ignorance of the losses of the "lambs" and a magnifying of the gains when they are made tend to blind the unsophisticated to the real chances they have of gaining and losing. Such losses would be materially reduced if people who intended to speculate in futures had governmental or board of trade reports before them showing the real situation.

Government Supervision.—In the second place, the government may very possibly exercise some supervision over the boards of trade similar to the supervision of national banks. The control over the annual crops which the great grain exchanges exercise has become vested with a public interest such as exists in banking, railroads, and public utilities. Government supervision would necessitate an inspection of the books and records of all members of each exchange who trade in futures. Speculation based on easy credits could be ascertained and eliminated, the character and financial standing of each customer of every board-of-trade firm could be determined, and this information could then be used for the protection of customers. The reports of these findings, moreover, could be given wide circulation. Each member of the board of trade could also be required to send in monthly, quarterly, or semi-yearly reports reflecting his financial standing and the character of his transactions. Such governmental regulation and supervision would not hinder the operations of the professional speculator who makes a business of forecasting market conditions and backs up his judgment with his money, but it would tend to eliminate unfit speculators who stimulate undesirable standards of competition.

Reform from Within.—The third and perhaps the most important remedial force is found in the boards of trade themselves. Most of the boards of trade have fought exchange abuses, sometimes as a result of initiative from within, but more often because of the pressure of public opinion from without. Attempts to corner the market already constitute grounds for expulsion from the exchange, as do other practices which savor of oppression and unfairness. If boards of trade are to maintain themselves as independent organizations in a moderate buyer's market, it is well for them to modify their organization to meet new demands. Membership should

be open only to reputable grain merchants; new customers who desire to trade in futures should be closely scrutinized; market information should be closely guarded and used for the benefit of the customers of members, and not merely for members; and the spread of speculation due to the growth of private-wire houses should be checked.

The Conditions of Integration.—The extension of the principle of integration in marketing effort depends on the nature and number of market abuses which exist, and how prominent and serious they are made to appear to sellers and buyers. Long tenure of life for board of trade institutions in a seller's market depends on their reflecting the demands of public opinion; in a buyer's market it depends on their anticipating such demands. Every shift in market emphasis modifies existing exchanges, but the recent shift toward the buyer's point of advantage has not been pronounced enough to endanger the present mechanism by the force of integration. The longer the period of hesitancy before the market swings back to the seller's point of advantage, the more fundamentally will grain exchanges be modified by integrating forces; and the sooner it becomes again a seller's market, the less possibility is there of integrating forces seriously modifying present market mechanism. Integration is the effect, market movement is the cause; and a careful study of the latter indicates the possibilities and probabilities of the former.

CHAPTER XXI

CRITIQUE OF EXISTING MARKETING SYSTEM

Present Marketing System under Criticism.—The present system of distributing goods is under fire from many sources. Socialists, social reformers, co-operationists, communists, and many organizations of different kinds are complaining of the inadequacy of our distributive system, especially as regards retailing. Some fantastic plans have been advocated for eliminating middlemen by selling direct from the producer to the consumer. Other critics would have the government administer the distribution of goods, believing the old fallacy that through some miraculous power the government can accomplish for individuals that which they are unable to accomplish for themselves. Still others believe that co-operative societies must displace the present system.

Through all of this confusion of ideas, and in spite of the numerous indictments issued against the retailer, he continues to distribute nine-tenths of the goods consumed, while his numbers increase at a greater rate than population. It is true that this apparently healthy growth in numbers may merely be an appearance of success and permanence which in fact does not exist. In other words, there may be certain fundamental evils in our present system of retailing which will eventually corrupt the whole system and bring about its own destruction, thereby paving the way for some scheme in which these elementary errors do not exist. To analyze carefully these alleged disadvantages or evils[1] in our present system and ascer-

[1] E. P. Harris, Co-operation, The Hope of the Consumer, New York, The Macmillan Company, 1919. A stimulating exposition of present-day retailing evils.

tain how far they are in accord with the facts, is the work of the student of marketing and business problems. The answer to the question whether the present system of marketing must be scrapped, depends on whether the evils that do exist can be eliminated when their cause is known.

Principal Charges—1. Undue Influence.—The first main criticism against the present market system is that advertising and salesmanship do not confine themselves to furnishing what it is found the customer wants, but exert a subtle and powerful influence in determining what the customer *shall* want. It is asserted that whereas formerly customers were definitely aware of the goods necessary to satisfy their needs, they are now forced to the defensive; that they no longer buy on their own initiative but merely purchase those things that they are importuned to buy. Thus the customer no longer makes independent choices but is controlled by the will of producers and distributors of commodities. Moreover, it is urged that this outside influence often acts unconsciously on the customer so that the latter may believe that he is making the best choice.

Bringing Unconscious Wants into Existence.—This criticism rests on a hasty analysis of the situation. The fact is, rather, that in most cases the retailer co-operates with the manufacturer in educating the public to realize that new capacities for satisfying unborn wants have been created. The process described as "creating wants" is merely that of bringing into consciousness wants that already exist. Capacity cannot be created if the ability to utilize does not already exist. This is illustrated by the entrance and hasty exit of the hobble skirt. Producers and distributors could not "create" a capacity or desire for utilizing that commodity. Attempts to force on consumers merchandise which was the "latest," the "rage," the "most commonly desired by the best people," have often

failed of success. The most aggressive and clever advertising and salesmanship have been unable to sell two-colored shoes in some localities. On the other hand, the need and desire for better cooking utensils undoubtedly existed long before aluminum cooking utensils came on the market, but salesmanship and advertising had to exploit the advantages of this merchandise before the public became conscious that a long unfilled want could now be satisfied. If aluminum ware had been discovered fifty years ago it would just have surely discovered its counterpart, viz., desire.

To maintain, therefore, that the customer no longer makes independent choices but is controlled by the will of producers and distributors, is to overlook the facts. It is more accurate to say that modern advertising and salesmanship ascertain wants, rather than to maintain that they determine wants. The successful merchant or manufacturer recognizes and works in harmony with this principle.

Need of Better Salesmanship.—The charge that retail stores deliberately induce customers to purchase goods which they cannot use is for the most part unfounded. Cases where customers have purchased goods ill-adapted to their purpose can usually be traced to ignorance on the part of either the salesperson, the customer, or both. In the past, retailers have paid too little attention to the education of their sales force, and, in so far as the customer has been wronged, the retailer can be justly condemned for laxity and short-sightedness. With so many new goods coming on the market with their complexity of construction and clever substitutions, the customer cannot be expected to be aware of their true character. Years ago, when the range of selection was narrower, and when keen competition had not flooded the market with undetectable substitutes, the customer could be his own expert. It was not then necessary for the salesperson to know all about

the goods. At present, however, it clearly devolves upon retailers to educate their salespeople so that they can give the customer the expert advice which he needs. Unless this is done, the retailer will continue to be charged with dishonesty.

If the customer inquires whether hose are all-silk, the salesperson should be able to say whether they are pure thread silk, manufactured silk, fiber silk, or something else. Only too often the salesperson says, "Yes, they are pure silk," when in reality he does not know the facts because no one in the store has instructed him. The customer makes the purchase believing that it will satisfy his requirements. When, after a time, short ends appear, indicating that the hose are made of manufactured silk, the customer believes that the store has used "salesmanship" on him in order to get rid of some inferior merchandise. The truth is that salesmanship is not to blame, but rather ignorance, lack of salesmanship.

There are no doubt cases where salespeople, because of a special or extra commission, have striven hard to sell old, worn, defective, or otherwise unsatisfactory goods. Such merchandise, however, is worth the money that is asked, for certain classes of people. Some customers are not particular about having the newest style cloak or shoe; others are willing to purchase shop-worn or defective goods if they can be purchased at a bargain. It is to the advantage of all the customers of any store to have its old stock disposed of rapidly, so that capital will be released for newer and more attractive merchandise. The way in which this release is accomplished must be given more careful thought in the future.

Goods on Approval.—The criticism that customers purchase commodities not suited to their needs loses its force still further when it is realized that most stores at the present time have a policy of "goods sent on approval." A generation

ago, excepting in a few of the larger cities,[2] this policy did not exist, and the advantage lay wholly with the store and its selling force. Today, customers may make their decisions after placing the merchandise in the surroundings for which it is intended. Rugs, furniture, decorations, clothing, labor-saving devices, and many other goods are daily being *used* before decision to buy is reached.

The Question of Quantity.—The present retailing system is often criticized, not only for not giving customers the right quality, but also for giving the wrong quantity. Usually the accusation is that too much is given rather than too little. In other words, it is supposed that the salesperson desires to "load" the customer whenever the opportunity presents itself. No doubt there was once a good deal of justification for this criticism, but importuning customers to purchase more merchandise than they can satisfactorily use has now become a thing of the past in most stores. In fact, the pendulum has swung too far in the other direction in many instances.

To fail to suggest a larger quantity is often as gross an error as "loading." For example, a lecturer was in a men's furnishings store in June looking at hose. He found some champagne-colored silk hose which were entirely to his liking. He purchased only two pairs although he knew that he would need at least four times that number during the summer, but he thought that he could purchase others as he needed them. What was his disappointment when he discovered, after calling for these hose at different stores in several towns, that they were not to be secured. Every merchant said that he had had only a few pairs, which he had quickly sold, and word soon came from the manufacturer that this line had been discontinued. If the salesperson had realized that it was to the

[2] Golden Book of the Wanamaker Stores.

customer's interest to have more pairs of this color and material, he would have suggested the purchase of more than two pairs.

The Customer's Viewpoint.—The hopefulness of the retailing situation is evidenced by the more widespread realization among retailers that only by pleasing and satisfying the customer can the most complete success be assured. Salesmanship which gives the customer cause for future regret is fast going into the discard, and it is important to note that this change for the better is coming from the retailers themselves as a consequence of their competition to interpret customers' desires.

2. **The Motto of "Caveat Emptor."**—The second main criticism of the system of retail distribution is that the old policy of *"caveat emptor"*—"Let the buyer beware!"—is still dominant. This charge is untrue. Unquestionably, in former days, trade was looked upon as a combat in which the interests of the customer were opposed to those of the retailer, and vice versa. This idea persisted because of a false idea as to the nature of exchange. It was believed that when goods changed hands only one party to the transaction could gain; that the other must necessarily lose. Hence, both buyer and seller exerted all of their powers of cajolery, cunning, browbeating, and higgling, in order to get the best of the bargain. The customer naturally looked upon the retailer as an enemy, as one to be feared, from whom, however, it was necessary to procure the necessities of life. On the other hand, the retailer came to look upon the customer as his natural prey to be taken advantage of if possible.

"Caveat Emptor" No Longer Dominant.—This situation has changed markedly for the better. Many of the harmful

practices of earlier days have been eliminated. Both retailers and customers are realizing that trade is not based upon mutually exclusive advantages, but upon mutual benefit. It is being more clearly comprehended that in an exchange of goods one party cannot rightly exclude the other from the advantages of the trade. If a store is selling apples for money, the store needs money more than apples, since expenses must be met and bills paid; while the customer needs apples more than money because he has several units of the latter but none of the former. Each party to the selling transaction parts with that which holds the least value for him as compared with the article in the control of the other party. Articles of small utility (or capacity to satisfy wants) are exchanged for articles with large utility, hence there is a greater total utility in the hands of both the buyer and the seller.

The "One-Price" System.—The last generation has seen almost universal acceptance of the "one-price" policy. Formerly, prices for identical goods were different for different customers on the same day. They were fixed by the judgment of the salesman as to what the customer would be willing to pay—and then quoted somewhat higher. It was the right of the customer to "beat down" this price as far as possible, while it was the custom for the retailer to relinquish only that portion of the quoted price which was necessary to consummate the sale. Under the one-price system all this unpleasantness and combat is done away with, and all customers are treated on the same basis regardless of their bargaining power. The price of each article is marked in plain figures and on any one day this price is maintained for all customers. If it is found necessary to mark the goods down at some later time, all customers have equal purchasing chances.

New Devices of Service.—Many other devices have been put into operation in the attempt to win and retain the confidence of the customer. Some of these policies are: marking "seconds" as such, and "firsts" as such; assisting the customer to purchase wisely; insisting on accuracy of statement in advertising and selling; giving the customer the benefit of economics and efficiencies; looking after the customer's bodily comforts. These developments of recent years indicate a new viewpoint in merchandising. A buyer's market has made necessary a greater conservation of the customer's interests.

It may be conceded that in many stores the motto of *caveat emptor* is still too largely followed with respect to matters of the style and design of goods and their suitability for specific purposes. Too many stores take the position that, with regard to these points, the customer must be his own judge; if he makes a mistake, "he should have known better." In such stores customers are permitted by ignorant salespeople to fit themselves short in shoes; to choose wrong colors and designs in garments; to select furniture which is too expensive or too cheap; to desire large hats when they should wear small hats; to wear unbecoming styles; and in general, to purchase goods which, although in themselves genuine and first-class articles, are permitted to function under circumstances for which they were never intended. Stores in which such practices continue, however, are lagging behind the procession. The defect is lack of intelligent salesmanship.

Co-operative Stores No Remedy for "Caveat Emptor."—Admitting, however, that the present system can be censured for not having yet fully eliminated the policy of *caveat emptor,* it is difficult to see how the plan of co-operative stores can eliminate this. In co-operative stores the tendency is to employ cheap salespeople, and, so long as salespeople are not experts, customer-satisfaction cannot be complete. Under the

present system, competition is forcing merchants to employ experts; but under co-operation the possibility of systematic training of salespeople would be remote because of the expense it would entail. Where people are dealing directly with the management or its equivalent, scrutiny of expense is overemphasized, while service may at the same time be criticized. The competition of private stores has, nine times out of ten, proved too much for co-operative enterprises, because of this lack of realization on the part of the shareholders of the relation between expense and service. In privately controlled stores customers know that they get the service but they do not realize the expense in furnishing it; so long as selling prices of goods are not higher than those of competing stores, the customers are satisfied. In short, to eliminate the evil of *caveat emptor,* it is not necessary to construct a new marketing system; it is sufficient to improve the one in existence.

3. **Retailer's "Advice" Too Costly.**—At this point a third main criticism of the marketing system presents itself. Even granting, it is urged, that the retailer is able to give the consumer advice and counsel in purchasing, the cost of this service to society is prohibitive. It is said that the retailer's "advice" costs the consumer about a billion dollars a year, and as it is biased, it is not worth this amount to society.

The Advice Indispensable.—This point has already been covered by implication. It is sufficient to say that goods are not *produced,* in the true sense of the word, until they are marketed—until they reach the consumer. The advice of the retailer is part of the costs of getting the goods to the consumer. No matter how expensive this process, it is worth the price, provided, first, that the goods are marketed economically, and secondly, that the advice of the retailer produces results that are satisfactory to the consumer.

It is evident that for each customer to work out the values of each article for himself would be uneconomical. Some specialized agency must perform that function. The retail store attempts to transmit to the customer the information given it by the manufacturer, manufacturer's demonstrator or salesman, jobber, wholesaler, or importer. The knowledge about the goods is part of the goods; the two cannot be separated. If the goods are sold without explanation, the customer has not received what rightly belongs to him.

It is evident, also, that if the advice of the retailer produces results that are satisfactory to the customer, the amount of money such advice costs the customer is justifiable. Competition between stores is continually seeking to bring out the truth about the goods; it is continually exhibiting shallow attempts at deceit. Customers are seldom tied up, body and soul, to any one store; they shop. Extravagant claims may be made by some dealers, but these may be offset by modest assertions backed up by a reputation for honesty on the part of others. Biased opinions regarding merchandise exist, just as biased opinions exist regarding politics, religion, education, etc., or any other subject—and for the same reason, viz., because people think differently and see things in different ways. Only in the minority of cases are biased opinions purposely advanced to mislead the customer. Permanent trade is desired by most merchants, not merely present sales. To secure permanent trade the customer cannot be made the victim of consciously biased advice.

Only through the statement of rival claims can the truth be most easily sifted out. In the case of vacuum cleaners, one salesman says that his machine has three points of superiority over his nearest rival, viz., (1) the switch will not get out of order; (2) the motor is dust-proof; (3) it beats as well as sweeps the carpet. The salesman of a competing machine says that, while all this may be true, his com-

petitor's machine takes the nap off the carpet and is, therefore, fundamentally destructive. On the basis of such claims and counterclaims, a buyer is stimulated to sift out the truth and arrive at an intelligent conclusion.

It may be true, and often is, that salespeople really believe that their article is the best. Naturally their advice and counsel is biased if they have not examined the entire field of similar merchandise. The customer should be stimulated by salespeople's claims to investigate the relative superiority of goods as regards the purpose it is desired they should fulfil. Some intelligence on his part must be assumed. It cannot be expected, however, that stores will be without honest bias.

4. Alleged Stimulus to False Standards of Living.—The final charge against the existing marketing system may be summarized in the assertion that it tends to establish false standards of living. This contention, if true, is fundamental and most grave.

It may be conceded at once that the immediate effect of the marketing methods of today is to make people dissatisfied with old ways and accustomed goods; to make them desire indeed not only new goods but better goods and more of them. Advertising and salesmanship are continually seeking to acquaint consumers with better methods of satisfying their daily wants, as well as revealing the existence of wants which formerly were unobserved. Labor-saving devices are sought for, to perform the functions of daily life which have been performed time out of mind by human muscle. Modes of shelter are sought which will not merely afford protection against the elements but which will express the personality of the owner. Clothing which gives grace, freshness, beauty, respectability and distinction is now demanded, as opposed to that which seeks only to cover nakedness or conserve bodily heat. Musicians from afar, with sentiment and emotion of

distant lands, now supplement the meager offerings of local talent, either in person or by proxy. Foods of the garden or neighborhood have their monotony broken by rare foods brought from the four corners of the earth. These and other goods too numerous to mention have been produced or brought from a distance and then have been advertised in order to stimulate the demand for them which exists although unrealized. Because, whether he knows it or not, man craves everything that will minister to his comfort.

Open-Mindedness the Condition of Progress.—Now, the willingness to change habits when it is advantageous to do so, exhibits an open-mindedness which is a condition of all progress. The New World would never have been discovered if Columbus or someone else had not accepted the idea that the earth was round. A willingness to change habits of thought had to exist beforehand. New methods of factory management which have increased production several hundred per cent, have made headway only because of the willingness of American enterprisers to try out something which had never been tried before. Likewise, the American farmer is using devices of production which were unheard of a generation ago. He does this because his mode of thought has not become static through custom and precedent. Mobility of thought, then, is of the utmost consequence to the welfare of the individual and the race.

It must be borne in mind, however, that change, innovation, may not always mean immediate progress. Where experimentation is practiced, much apparently futile effort may be expended before some advance is made.

Before the Industrial Revolution.—There was a time in England, before the Industrial Revolution, when every increase in income for the masses meant larger families and

increased drunkenness. Because of this vicious circle public leaders were not enthusiastic over increased income for laborers, and in some cases used governmental power to aid employers in retaining old wage rates. A certain clergyman by the name of Malthus became well-known through his essay on population wherein he maintained that progress is handicapped because population increases at a geometrical ratio while means of subsistence increase at an arithmetical ratio. Because of this supposed tendency of population to outstrip food supply, the people of that day were pessimistic as to the possibilities of raising the national standards of living. Malthus even went so far as to suggest the beneficent nature of wars, pestilence, starvation, vice, and crime in retarding the encroachment of population on food supply.

In the light of present-day production and standards of living, the views of Malthus and his contemporaries appear unreal. Yet at the time these views were held conditions seemed to justify them. In those days the only leash to elemental passions among the mass of the population came from negative restraints. When forces over which the laborer had no control gave him higher wages, he merely maintained his old standard of living and used the increased wages in satisfying his sexual instinct or physical appetites.

Social Benefits of Increased Production.—What has arisen in the last two hundred years to change the old condition of affairs? What has made it possible for the wage-earner to raise his standard of living, year by year, so that children continually have advantages and comforts unknown to their parents? The answer is, the increased production of goods made possible by power machinery and specialization, plus the appeal which these new goods make to consumers. The negative restraints which formerly held mankind to their old standard of living have been displaced by positive attractions

which enable men to set their standard of living higher. Goods, made attractive by advertising and salesmanship, forcibly impressed the worker with the possibilities of an increased income. This stimulus has led to increased wages, not caused merely by natural causes over which the laborer has no control, but even more by his own initiative or will to produce more goods so as to get more of all kinds of goods.

This stimulus to increased endeavor is the most important result of machine production and specialization. Yet another result, only second in importance, is the healthy outlet created for the increased income. That is, goods in all their present attractive forms absorb the increased income stimulated by these very goods. Thus the new circle is from increased production of goods to increased income of consumers, which causes increased demand for goods followed by increased production.

The Rising Standard of Living.—Certain critics of the present system, however, are tempted to think that the process just described has brought more harm than good. They see people striving strenuously for money to purchase goods which they (the critics) believe are not worth the effort. It may be worth while to attempt to ascertain briefly the nature of the goods which are not worth the effort to secure. Obviously, physically injurious commodities would come under this classification. The number, however, of these goods is constantly decreasing, due partly to the operation of laws, public opinion, business principles, and moral obligations. Classes of goods constantly increasing in consumption are: house furnishings, clothing, shelter, foods (especially rare ones), and luxuries—art works, education, automobiles, labor-saving devices, jewelry, travel, philanthropic service.

Possibly phonographs, stylish clothing, automobiles, fancy

foods, and fashionable furniture are not worth the effort expended to acquire them—but that is not the important question. The important question is, can the increased income which exists because of these enticing means of satisfaction be used for more durable and lasting commodities like education, art, philanthropy, drama, literature, and the like? There is no doubt that this will gradually be accomplished. The generations of the future will utilize more desirably the increased incomes derived from specialization, machinery, and the stimulus of advertised goods. But first of all, the income must exist, and at present it does exist, not only as a result of machinery and specialization, but because it finds an outlet or a capacity for being utilized in the many goods placed on the market.

It is by no means evident, moreover, that in the majority of cases present-day purchases comprise goods which are not worth the effort expended in acquiring them. Nine purchases out of ten mean greater comfort and happiness for the customer. Purchasing a new suit in order to be well dressed, even though the old suit is not worn out, may seem a waste of effort. A little analysis, however, will indicate that there is no intrinsic value in the suit itself; value only attaches to it when it is socially valued, i.e., when people co-operatively appraise its worth. If newness and freshness are qualities in clothing which this generation admires, this social value must be the one that is preponderantly considered.

A higher standard of living is thus being developed because of greater income. This higher level of comfort and happiness may appear meager and inconsequential to generations that follow, but for those who are now experiencing the satisfaction of new desires it is significant.

The Charge of Materialism Not Valid.—It may be urged, however, that all this is an enormous stimulus to a materialistic

view of life and to disregard of higher things. While this charge of materialism is so commonly made against present-day society that many believe it because of its very persistence, strong evidence exists to prove that it is unfounded in fact. The truth is, on the contrary, that the production of goods has in itself exhibited to men possibilities of spiritual development which were hitherto unrealized.

Unquestionably, with the introduction in homes of each new article of modern productive processes has come the habit of using it, and the indisposition to do without it. This natural disinclination to give up what has already become common through use is a standard of living. It is a conception of well-being which men will fight for rather than give up. It is the inheritance of a century of greater material progress than the world has ever seen. It is dependent upon goods—goods in greater quantities, goods in ever increasing varieties. To allege that the present marketing system is faulty because it places emphasis on goods, is to say that life is defective because it depends on life.

A Sound Basis for True Progress.—The truth is all against the contention that increase of material comfort has bred materialism. With the invention of the steam engine in 1760, and the resulting Industrial Revolution, when goods were produced on a scale formerly undreamed of, standards of material life began to rise. At the very same time education increased in importance. A breaking away from precedents and a new spirit of rational thought and conduct characterized the new society which was evolved from the poverty stricken hordes of the previous centuries. The concern for education and for higher moral values throughout society has grown steadily with the increase of material welfare. The minimum wage, child labor laws, short hours for women, sanitary regulations for shops and factories, accident prevention

devices, social welfare bureaus, arbitration boards, conciliation committees, and similar institutions, are evidences of attempts at a practical application of the Golden Rule. Moreover, a new morality is in evidence among business men, and a growing desire to give a "square deal" to all with whom they carry on business dealings. It is safe to say that the further men get away from the competition for bare subsistence, the tooth and claw age, the more will they heed and apply the fundamental principles of religion.

A sound economic basis is necessary for a permanently healthful spiritual development. Heretofore, such an economic basis has not been possible, but with the rapid advances in productive enterprises it may be possible within the next few centuries to lay the foundations for a real, invigorating religion. This will have to be a natural growth, religion developing along with the growth of material wealth, until one becomes part of the other in a standard of living which through habit will become permanent.

APPENDIX

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